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May/June 1983 AEI Journal on Government and Society

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Milton Mueller

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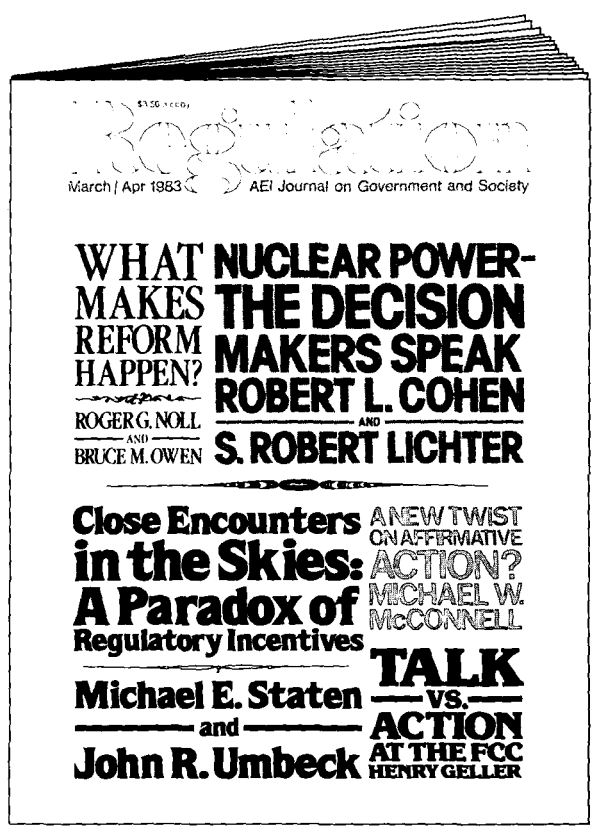
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LETTERS 2

PERSPECTIVES on Current Developments 5
A Reconstituted Threat to the Milk Cartel
Health Benefits for the Jobless: The Middle Class Cashes In
And Now, a Spectrum Bubble
CAB + ICC + FMC = NTC?
In Brief—

VIEWPOINT: Bootleggers and Baptists—The Education of a Regulatory Economist 12
Bruce Yandle

Airwaves for Sale?

SOME THOUGHTS ON BROADCASTING REFORM 17
Kenneth Robinson

SPECTRUM FEES VS. SPECTRUM LIBERATION 21
Milton Mueller

REPEALING RULES 26
James V. DeLong

THE FALL OF THE HOUSE OF USERY: Federalism in the Supreme Court 31
Grover Rees III

ON THE NEOLIBERAL FRONTIER 38
A Review of Robert Reich's *The Next American Frontier*
William Kristol

READINGS of Particular Interest 41

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Letters

We welcome letters from readers, particularly commentaries that reflect upon or take issue with material we have published. The writer's name, affiliation, address, and telephone number should be included. Because of space limitations, letters are subject to abridgment.

Antitrust Laws and the Competitive Economy

TO THE EDITOR:

Fred L. Smith, Jr., presents a strong case for totally abolishing the antitrust laws ("Why Not Abolish Antitrust?" *Regulation,* January/February 1983) based on five contentions: (1) that, as libertarians argue, individuals should be free to do with their property as they wish; (2) that neoclassical equilibrium theory is misleading; (3) that price fixing will fail in the long run; (4) that "price-coordination" arrangements improve economic efficiency; and (5) that the antitrust laws have been used in ways that reduce efficiency. Although I sympathize with Smith's view that antitrust is another form of regulation and is therefore suspect, and although there are elements of truth in his position, I must challenge it nonetheless.

Smith argues for exempting trucking firms and their rate bureaus from antitrust laws. However, it is poor policy to exempt some industries from certain laws while demanding that others meet them. Laws should be applicable to all. Moreover, the trucking industry at the moment is not totally deregulated. Entry controls still exist, although they are weaker than in the early 1970s, and new competition is not yet strong enough to erode the monopoly profits from price fixing. Until entry is totally free, antitrust exemption will foster inefficiencies.

More fundamentally, I cannot support the abolition of all antitrust laws. Let me take up Smith's arguments, starting with the ones I agree with most. I agree with point (2), that the neoclassical theory of perfect competition is misleading when applied to antitrust, but this by itself does not justify price collusion. I also agree heartily with point (5), that these laws have often been used to suppress competition and attack successful competitors. However, these abuses have arisen not from the rule prohibiting price fixing but from the misuse of other antitrust doctrines such as unfair competition, attempting to monopolize, and "restrictive practices." If Smith wishes to abolish the prohibition on price fixing, he must show specifically how section 1 of the Sherman Act has reduced competition.

In support of point (4), that price fixing can increase efficiency, Smith cites the work of Hayek and Sowell on the role of markets in providing information about costs and values. I agree completely with my colleague Sowell on this issue. Price fixing, however, does not create information but destroys it. Cartel agreements or rate bureau tariffs are set so that most participants can cover their expenses. Unanimity is a cardinal rule in all such agreements. Low-cost carriers or firms cannot capitalize on their efficiencies through lower rates. No single buyer or seller knows overall costs; most firms do not know their own costs very well. Only through the haggling and jiggling of the market can low costs and efficient techniques be truly identified. Price agreements based on unanimity do not provide this information.

Smith argues in point (3) that cartel agreements are short-lived. The empirical evidence for this proposition is weak. Moreover, he contradicts his own argument when he cites "the survival of cartel arrangements in some open markets for long periods." Certainly the De Beers diamond cartel has lasted decades; the oil cartel has survived surprisingly well. Some railroad cartels in the nineteenth century lasted for more than a decade.

His argument for individual property rights—point (1)—is based on a view of morality that is less than unanimous in the world. He argues that people have a moral right to do anything they wish with their property. Few of the world's great religions would subscribe to this libertarian position, and postulating such a right is surely unconvincing to many.

To sum up, I would agree that all antitrust laws should be abolished except the prohibition on price fixing. This is the most procompetitive section of the Sherman Act, and the one portion that can be enforced with a minimum of discretion and a maximum of objectivity.

Thomas Gale Moore,
Hoover Institution

TO THE EDITOR:

Like many people, Fred Smith seems to be unaware of how well antitrust has worked in stimulating competition. It deserves much of the credit for the large increase in competition that has taken place during the last two decades (summarized in "Readings," *Regulation,* March/April 1983). That is why, contrary to Smith's argument, antitrust needs to be strengthened rather than abolished.

Since 1960, antitrust actions have directly raised competition in at least twenty substantial markets, from aluminum, metal cans, electrical equipment, and photographic supplies to banking, broadcasting, and automobile rentals. And the real influence of antitrust reaches much farther even than the classic federal cases that are filed and fully litigated. Most of it occurs unseen through negotiations and threats that deter mergers and other actions. The antitrust agencies often intervene in regulatory cases through informal persuasion, by threatening to go to court or through testimony at formal public hearings. Such antitrust pressure was important in pushing forward every one of the seven major instances of deregulation in the 1970s, from airlines to stockbrokers' fees. Private and state-level antitrust actions have also become an important part of the process, at the grass roots of the economy.

Consider also the general force of antitrust precedents, by which one landmark case often affects hundreds of other companies. Many early antitrust actions still exert pressure through consent decrees. Since 1975 the advent of jail sentences and stiffer fines has reduced the degree of price fixing in probably hundreds of markets. . . .

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Yet even as antitrust has been having this strong cumulative effect on competition, it has come under new criticism. Corporate groups have welcomed the end of the big IBM and cereal cases, which they say were too big, too slow, and too unrealistic.... Dropping these cases was probably an economic mistake that reflected the policy tilt of the current Reagan appointees at the agencies. Ideologies and self-interest are now threatening antitrust just as it is providing a rich harvest of rising competition.

A strong antitrust policy remains the pivot of U.S. industrial policies. It operates widely and flexibly, even though it often lacks precision and political suavity. Its presence sharply distinguishes our competitive economy from others abroad, with their habits of meshing government and industrial planning. The neoconservative attack on antitrust policies is therefore doubly unfortunate. While scoring easy debating points over a few complex cases, it has ignored the great body of sophisticated activity that antitrust really comprises. And it would have us discard much of that activity just when antitrust has helped to provide—and is needed to maintain—a much more competitive economy. . . .

William G. Shepherd,
University of Michigan

TO THE EDITOR:

Fred Smith says there is little empirical evidence that truckers have succeeded in harming consumers by fixing prices. He is simply wrong.

Under antitrust immunity and in a putative regulated environment, rate bureaus have pushed rates above the level that could be sustained in a fully competitive market subject to antitrust enforcement. Carriers can pass on wage and expense increases collusively to shippers and ultimately to consumers, which has lowered the carriers' incentive to resist those increases. The industry itself evidently believes collective ratemaking boosts its profits, since it has claimed that the process is vital to its financial integrity. Public data show that while industry output was declining in tonnage by more than 40 percent from 1978 to 1982, industry revenue was increasing under the current antitrust immunity, despite ICC rate regulation.

Smith also believes that collective ratemaking in trucking can enhance economic efficiency through "price coordination." Aside from the self-serving assertions of the rate bureaus that he passes along, there is little evidence for his claim. The fact is that collective ratemaking has resulted in astoundingly high transaction costs. After decades of price coordination, most carriers do not even know their costs and many shippers pay enormous sums to obtain accurate information on prices and service options. Moreover, an army of rate experts is needed to prepare and defend rate proposals in administrative proceedings, while legions of others are needed afterward to interpret the tariffs in order to determine the rate for a given shipment.

Regulated cartel ratemaking has contributed to low industry efficiency in other ways as well. Since most carriers have at best a faint notion of what their costs are, there is no systematic relationship between costs and rates. The resulting rate structure encourages the misallocation of freight shipments, including misallocation from more efficient to less efficient carriers. Moreover, industry studies and witnesses have repeatedly shown that labor productivity has in fact declined over the past dozen or so years, despite many opportunities for improvement. In short, the performance of trucking markets under the umbrella of antitrust immunity provides no support for Smith's case.

Larry F. Darby,
Motor Carrier Ratemaking Study Commission

TO THE EDITOR:

In a curious and coincidental way, both Fred Smith's "Why Not Abolish Antitrust?" and Frank Easterbrook's "On Not Enforcing the Law" (*Regulation,* January/February 1983) underscore the danger that policy makers will lose touch with the mainstream of our free market democracy.

After noting that Lester Thurow and other "neoliberal" economists would abolish antitrust in the name of a new national industrial and incomes policy, Smith supports the same legislative route to the ostensibly opposite goal—libertarian private enterprise. While Smith's anti-regulatory, pro-liberty goals have broad support, he does not recognize that antitrust legislation has equally broad support of a primarily political nature; it historically appears as a popular response to and check upon capital, whether or not it enhances allocative or distributive efficiency in the short term.

The one period in our history in which antitrust was legislatively curtailed, if not abolished, was the New Deal, in which popular sentiment favored vastly increased and intrusive government regulation of business coupled with antitrust immunities. In the absence of a Great Depression, however, most voters do not see much difference between coercive governmental power and the threatening power of private capital. Certainly our democratic process will not long allow private capital to control government policy simply in the name of private property rights. Again and again during the past century, beginning with the original state corporation codes, the populace has insisted on policing the free enterprise system, even subjecting errant or domineering capitalists to criminal sanctions whatever economists may think. An otherwise conservative policy that does not understand antitrust's symbolic role in protecting a middle class will never retain popular support. If antitrust is abolished, we will eventually wind up with a Galbraithian "new industrial state."

The rest of Smith's argument—that businessmen and professionals do not really seek to profit from coercion, cartels, or short-term monopolies and that, even if they do, consumers and the market system are not harmed—cannot be taken seriously by those familiar with the records of antitrust trials. Smith should take more time to review the testimony of marketing vice-presidents and purchasing agents under oath in court, and the obvious market signaling economists have found in particular markets—unless, that is, he is taking a global, extended view of the players, in which the elimination of small businesses, the inhibition of potentially diverse sources of supply, and the "temporary" high price levels of gasoline, uranium, quinine, road building, and so on do not count.

Easterbrook's piece appears to be an arrogant defense of unilateral lawmaking by the executive branch, particularly the Antitrust Division—conduct that orthodox conservatives normally would abhor. But could it really be a tour de force of parody? When critics argue that Reagan antitrust chief William Baxter is defying the democratic process by attempting to abolish antitrust regulation by fiat, the "simple" answer Easterbrook offers is that Baxter is really behaving like Thomas Jefferson, who refused to enforce the un-

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constitutional alien and sedition laws, or local prosecutors who use their recognized "prosecutorial discretion" in declining to prosecute drug offenses. Easterbrook thus challenges the notion that there *is* a rule of law in antitrust, or that the Justice Department is failing to carry out its Article II responsibilities when it announces that it will not prosecute broad categories of lawbreakers.

Thus he reassures his conservative readers, worried about the binding legislation and Supreme Court precedent on these matters, that lawmaking power can be safely turned over to an omniscient prosecutorial ayatollah and his cadre of Chicago-school economist mullahs. Shades of Wild Bill Douglas! The design, I suspect, is to prevent a schism between those Reagan supporters who are primarily advocates of helping big business and private capital, regardless of how the governmental process is used to do so, and others, perhaps Reagan himself, who still believe in the rule of law, the democratic process, and the limited but necessary role of government in preserving liberty.

Encore, Professor Easterbrook!

James F. Ponsoldt,
University of Georgia
School of Law

FRED L. SMITH, JR., responds:

My article was aimed at readers who were familiar with, and had generally been convinced by, the Chicago-school critique of most antitrust regulations. Shepherd's and Ponsoldt's letters remind us that the conventional wisdom still refuses to accept this critique—which shows how far we still have to go to gain acceptance of even the limited steps taken by James C. Miller III and William Baxter.

Shepherd is representative of the once-dominant structuralist school, which pronounces an industry competitive only if it has the correct statistical stigmata: low concentration ratios, high entry/exit rates, lack of "supra-normal" profits, and so forth. This school's pursuit of numerical "competition," whatever the cost to consumers, provided the intellectual base for the cereal case and the other absurdities that did so much to discredit antitrust during the 1970s. Indeed, given Shepherd's principles, it is hard to imagine a proposed break-up that he would oppose.

James Ponsoldt offers a "vox populi, vox dei" argument: the populace thinks it needs protection against the "excesses" of private capital, and antitrust is a less costly way of providing that protection than national planning or a Galbraithian "new industrial state." This begs the question twice. First, the public will demand a policy if opinion leaders convince them it is needed to avert inevitable business control of government, inherent tendencies toward monopoly, or whatever. The question is: should the opinion leaders change their tune? Second, although popular sentiment may serve as a handy pretext, the most salient political support for antitrust comes from the special interests that it benefits. Antitrust does not cure the business-government entanglement Ponsoldt rightly complains of, but exacerbates it.

Ponsoldt says he cannot take seriously my argument that "businessmen and professionals do not really seek to profit from coercion, cartels, or short-term monopolies." Let me make clear that this was not my argument. Certainly such groups seek to profit from any action they undertake—why else would they do it? I merely noted that no evidence exists that this profit seeking in fact harms anyone. The court records Ponsoldt suggests I review do show that price fixing has been tried, but also that such attempts have rarely succeeded and that, as I noted in my article, consumers often testify for the supposed evildoers. Of course I would never defend "coercion," defined to consist of the use or threat of force.

What about "small businesses, the inhibition of potentially diverse sources of supply, and the 'temporary' high price levels of gasoline, uranium, quinine, road building"? There is hardly time to linger over every one of these points, but it is worth noting that even most liberal Democrats no longer believe in trying to protect small business at the expense of the even smaller consumer through such measures as the Robinson-Patman Act. As for road building, Ponsoldt is handing me easy ammunition for my arguments: highway construction offers a perfect example of how government can run a purchasing operation without even minimal competence (not to say honesty) and then call in the antitrust enforcers to save it from the mess it helped create.

Larry Darby cannot seem to distinguish the "umbrella of antitrust immunity" from what went on underneath that umbrella: the ICC's coercive transformation of voluntary rate agreements into binding legal restrictions. At one point, he says that "truckers" have harmed consumers. At another, it is the "rate bureaus" that have pushed rates up; at yet another, it is "regulated cartel ratemaking." Darby's confusion between the rate bureaus' historic regulatory powers and the voluntary role they would play in a competitive market leads him to some odd conclusions. Note, for example, his comment that industry revenue increased under antitrust immunity from 1978 to 1982 "despite ICC rate regulation." "Despite" indeed!

Darby is quite right that under regulation carriers know little about their costs, shippers pay enormous sums to obtain price data, and experts are required to defend rate proposals. But since neither he nor I holds any brief for regulation, none of this is relevant. The only thing he says about prospective antitrust immunity is that the truckers' assertions are "self-serving," and I would remind him that not all "self-serving" assertions are wrong, even those that are made by truckers.

Thomas Gale Moore's remarks are in many ways the most frustrating because we start from such similar positions. We agree completely that the ICC retains dangerous powers to limit entry. And it is in the context of total freedom of entry that I raised the question of whether antitrust is required. But, after all, Reese Taylor has become a minority force on his own commission, and the current ICC majority is rather free-market-oriented. It is an open question whether economic freedom is better entrusted to that majority than to William Baxter, who (to judge from the American Airlines case) seems to view free speech as an impediment to antitrust enforcement.

Moore argues that it is "poor policy to exempt some industries from certain laws while demanding that others meet them." If we agree that a law is itself anticompetitive, however, would we not be better off allowing some increased competition rather than none at all? The deregulation of transportation itself began with selective exceptions to the general pattern of rate regulation in areas such as air freight. The political process is an incremental one, unlikely to reward all-or-nothing demands. Historically, Congress has disagreed with Moore on this point: it has allowed a great

(Continues on page 51)

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Perspectives
on current developments

A Reconstituted Threat to the Milk Cartel

There are two ways to reform anticompetitive regulation. One is to confront the regulation head-on and try to repeal it. The other, and by some measures the more promising, way is to encourage the spread of innovations that undercut the system by forcing the regulated firms to begin competing willy-nilly. Innovations of this sort have virtually transformed the competitive nature of the banking and telephone industries in a few short years. Now another system of regulation that had seemed impervious to reform, the federal milk marketing orders, is coming under challenge from an innovation that could save consumers hundreds of millions of dollars.

Reconstituted milk is milk that has been broken down into its solid components of dry powder and butterfat, and later recombined with water into fluid milk. The resulting mix tastes much more like fresh milk than anything you mix up from the dry milk powder sold in supermarkets. In fact, neither consumer taste-testers nor lab chemists can distinguish ordinary fresh milk from a blend of 70 percent reconstituted milk and 30 percent fresh milk. Reconstituted milk currently is sold in Alaska, Hawaii, and the Virgin Islands; the Department of Agriculture (USDA) thinks it could cut consumer fluid milk prices in the contiguous forty-eight states by about 5 percent, which would amount to hundreds of millions of dollars a year.

Reconstituted milk is not a new invention; in fact, it was perfected during the 1950s. But for years now it has been effectively regulated out of existence by special provisions in the milk marketing order system. In the 1960s the local marketing orders around the country were amended to require, in effect, that milk powder used to make reconstituted milk be priced high enough to bring the price of the resulting mix up to that of fresh milk. (Milk powder sold directly to consumers was not included and can be sold for considerably less.) These "down allocation" and "compensatory payment" provisions have virtually eliminated any incentive for dairies to sell reconstituted milk. Before a marketing order with such provisions was established in the Houston area, according to Joe Murphy of Associated Milk Producers Inc., reconstituted milk captured 30 to 40 percent of the fluid milk market; after the order was in place, reconstituted milk disappeared.

In 1979 the Community Nutrition Institute (a consumer group), three milk drinkers, and a dairy operator petitioned the USDA to eliminate these provisions. When the department dragged its feet on the issue, the petitioners went to court. They won an important skirmish in January 1983, when the U.S. Court of Appeals for the District of Columbia Circuit ruled that the milk drinkers had standing to sue.

In a sense, their suit is a challenge to the entire milk marketing order system. That system's essential features, which date back to the 1930s, are as follows:

- Each marketing order sets minimum prices for fluid milk in a given local area. These prices are supposed to be high enough to guarantee self-sufficiency in fluid milk for each area. However, the Agricultural Marketing Agreement Act, which authorizes the order system, and the commerce clause of the Constitution both limit the degree to which the government can insulate milk markets from outside competition. The minimum prices thus take into account the possibility of competition from nearby areas and are scaled upward as one moves away from the lowest-cost producing areas in Wisconsin and Minnesota. The highest-cost producers and thus the biggest beneficiaries of the scheme are dairy farmers in such states as Florida and Texas, and the biggest

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losers are consumers in those states. Since the 1930s, advances in transportation and refrigeration have made it possible to transport milk over greater distances, but even the highest-cost southern areas still produce much of their own fluid milk year-round.

- The minimum price of fluid milk sold to consumers is kept higher than the price of manufacturing-grade milk sold for processing into butter, ice cream, and other processed items. However, all dairy farmers within a marketing area get the same price for their milk, regardless of whether the particular dairy that buys their milk sells it in fresh or processed form. This is accomplished through payments into and out of a "pool" of all dairies of an area.

Economic critics characterize the marketing order system as one of classic cartelized price discrimination. The purchasers with the more inelastic demand, consumers of fresh milk, pay the higher price. (The demand for manufactured milk products in a particular area is elastic because they are relatively easy to store and ship.) Since there are no entry controls, cartel managers cannot prevent overproduction of fresh milk. They can, however, use the marketing order system to shunt the excess milk production onto the processed market instead of dumping it in rivers—which would violate EPA effluent guidelines anyway.

The system is economically inefficient, say these critics, in a number of ways. First, because of the price discrimination, it artificially discourages fluid milk consumption and encourages product consumption. Second, it subsidizes milk production overall, which adds to the already huge federal outlays on dairy price supports and stockpiles. Third, it discourages the transport of milk from lower-cost to higher-cost producing areas, with associated cost savings. Fourth, the costs the industry pays to administer the whole system are not negligible: $22.7 million was budgeted in 1976. Finally, according to a Department of Justice study, the system helps large dairy cooperatives, often including nearly all the farmers in a market area, acquire market power and raise prices above the legal minimum.

Supporters of the system, including the USDA, say it promotes "orderly marketing," a concept whose meaning is rather unclear. Most often it is argued that the price of fluid milk would gyrate in an open market because its demand and supply fluctuate seasonally in different ways—although it is hard to see why sales onto the manufactured-product market would not absorb these fluctuations. Marketing orders are said to provide a "margin of safety" by luring farmers to produce more milk than they otherwise would.

Even if fluid milk prices should happen to vary seasonally, as do the prices of fresh fruits, vegetables and seafood, it is not clear how that would harm consumers. They can hardly complain of unpredictability. Nature itself has decreed for ages that milk is especially plentiful in the spring. Besides, even under marketing orders the prices dairy farmers receive still swing seasonally. (Some economists, by the way, say the system may exaggerate the swings.)

The reconstituted milk issue provides an interesting test of the "cartel" versus "price stability" theses. If the purpose of the milk order system is cartelized price discrimination, reconstituted milk represents a dire threat, since no price-discrimination scheme can survive unless it can keep the low-price and high-price markets separate. If, on the other hand, the purpose of the system is the stated one of ensuring ample fluid milk supplies at stable prices, reconstituted milk seems like the ideal solution, since it allows dairies to break down milk where and when it is plentiful and reconstitute it where and when it is scarce. Either way, reconstituted milk undercuts the rationale for the two pillars of the current system: local self-sufficiency and the differential pricing of milk for fluid and product markets. That the system has nonetheless rejected the innovation is consistent with the cartel thesis, but not with the "orderly marketing" thesis.

It is possible that reconstituted milk could be the technological development that unravels the entire milk regulatory system. It is not that reconstituted milk has any across-the-board cost advantage: although it saves money not to have to ship water around in refrigerated trucks, it also costs money to dry and recombine the ingredients. But the current price differentials are so great that in 1980, when the Department of Agriculture considered the reform petition, it publicly worried that dairies might indulge in "uneconomic" reconstitution, drying milk and then recombining it on the spot in order to evade the minimum price rules. To meet that threat, dairy farmers probably would

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press USDA to lower the minimum price for fluid milk. USDA estimated that the revenues of dairy farmers would drop by 5 percent (by coincidence, the same percentage as consumer milk costs would drop) and that costs to the government in the separate support-payment program, currently running at $2.7 billion a year, would also fall. Manufactured-product prices would also rise, of course. But the Council on Wage and Price Stability calculated that, based on USDA's analysis, the efficiency benefits of reform would exceed the costs by $255 million a year in 1978 dollars, which would amount to $377 million in 1982 dollars—most of the gains coming not from the lower cost of the reconstituted milk itself, but from its competitive effect on the fluid milk market.

Health Benefits for the Jobless: The Middle Class Cashes In

The "conservative welfare state," much talked of by political commentators in recent years, is apparently about to get its first trial run. As of this writing, the Republican Senate is expected to pass, and the Reagan administration is falling into place behind, a bill to establish the first big new social program since President Reagan took office more than two years ago: health insurance for the unemployed. A different version of the legislation has already passed the House Energy and Commerce Committee.

The Senate bill, S. 951, is co-sponsored by Senators Robert Dole (Republican, Kansas) and David Durenberger (Republican, Minnesota). The House version, H.R. 3021, was introduced by Representative Henry Waxman (Democrat, California). Both offer matching federal grants to states to provide health insurance for laid-off workers who have lost their eligibility for employer-provided insurance. Eligibility for the new benefit would depend essentially on eligibility for state unemployment insurance or federal supplemental benefits. Recipients would come under coverage several weeks after they started receiving jobless benefits, although both bills make some provision for those whose jobless benefits have been exhausted. Coverage would continue for six months after jobless benefits stopped or one month after reemployment. Waxman's bill also would provide twelve months' coverage for those whose jobless benefits were exhausted at the time the bill goes into effect.

Under both plans beneficiaries could be required to pay a small part of the premium as well as deductibles and copayments out of their unemployment benefits; Dole would require more of this "cost-sharing" than Waxman. States would be allocated federal matching funds under a formula tied to their unemployment rates under both bills, with Waxman allocating more money to states than Dole.

Both bills would also shift some costs to employers. The Senate bill would require employers to provide an "open enrollment" period during which workers whose spouses had been laid off could convert to family coverage. The House bill would require employers after October 1985 to continue coverage for ninety days after separation, contributing the same level of premiums as for active employees.

According to Irving Kristol, conservatives should favor universal, Bismarckian programs that give benefits to rich and poor alike, even though such programs are much more costly than the "means-tested" programs targeted at the poor. The reason is that universal programs defuse discontent among the poor and working class and bind all classes more closely to the political system. The unemployed health insurance initiatives that have emerged so far, however, hardly fit the prescribed Bismarckian pattern. They manage, for the most part, to confer benefits on the middle class; but they deny them to a great many lower-income people. Many lower-income people who do not receive unemployment compensation would still not be entitled to health insurance, including widows and pensioners not poor enough for Medicaid or old enough for Medicare, workers whose employers do not provide health insurance (these workers are generally low-paid), and spouses and family members of those whose workplace insurance covers themselves only. At the same time, a great many of the unemployed who would qualify for benefits are in no way poor. When supplemental benefits and trade adjustment assistance are added to sources of outside income, many unemployed workers maintain an above-average standard of living—along with the prospect of returning to well-paid jobs as the recovery proceeds. Economist Herbert Stein recently wrote that

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"[p]robably only about 10 percent of the 10 percent who are unemployed are in poverty."

The Dole and the Waxman bills would target special unemployment compensation grants to states based on their unemployment rates—producing some anomalous results. An unemployed worker in one state (or part of a state) could be entitled to federal funds while an equally unemployed colleague in the next state would not. Moreover, the transfer of wealth from lower-unemployment states to higher-unemployment states would be accelerated, which is ironic because the lower-unemployment states tend to be poorer.

Proponents defend a program geared mainly to middle-income and experienced workers by noting that this group has a strong "labor force attachment" and that most of its members have paid taxes for years. This single proposal, it is argued, was not intended to plug the gaps in poverty programs. Still, it will be very hard to explain on equity grounds why subsidized health insurance, once it has been given to higher-income workers, should not be extended to lower-income workers—introducing national health insurance through the "back door." Unemployment compensation itself, by the way, is not open to this charge of inequity because it is paid for by participating employers and workers rather than by general tax revenues.

The Reagan administration has indicated that it will support the bill if it is "self-funding," meaning that it will not add to the deficit. It proposes to finance the program with the money raised by enacting an even lower "cap" than had earlier been proposed on the tax-deductibility of employer-paid health insurance. (The earlier proposed cap was $2,100 for family coverage and $840 for individual coverage.) Funneling the money back into federally paid health care will presumably negate some of the restraint the tax cap might have placed on medical costs, which are still rising at double-digit rates despite the slowdown in the general inflation rate.

And, of course, the total costs of the program—and stimulus to medical inflation—will naturally be much higher than the reported federal costs of $1 billion (Dole) and $2.8 billion (Waxman) would suggest. As we have learned from earlier proposals for national health insurance, it is deceptively easy for the federal government to load costly requirements on the private sector (see Jack Meyer, "Hiding the Costs of National Health Insurance," *Regulation*, March/April 1980).

In the evolving conception of the conservative welfare state, one of the casualties is the one-time conservative concern with incentive effects. Since health insurance would still not be guaranteed to workers with steady jobs under the plans, many workers would have to give up valuable health benefits as the price for getting off the unemployment rolls.

And Now, a Spectrum Bubble

The Federal Communications Commission took a small but intriguing step toward regulatory reform August 16, 1982, in a rulemaking opening up a previously unused part of the radio spectrum. The commission decided to allow the holders of the new licenses to follow any technical standard they want within their assigned frequencies so long as they do not interfere with reception on other channels.

The rule affects land mobile radio, a service that taxicab companies, police, and companies with delivery routes use to communicate with their vehicles. The FCC assigns each land mobile licensee a 25 kilohertz (kHz) band, which has sufficed to accommodate one channel with enough separation to avoid undue interference with adjacent channels. Up to now, the FCC has required these radio users to broadcast using the FM (frequency modulation) mode and to follow other exact technical specifications.

These regulations seemed natural enough when they were first imposed, since FM was the most practical form of transmission. But now new technologies are becoming available that economize on spectrum. "Single sideband transmission," for example, uses only about 3 kHz per channel. This would let license holders carve out five channels, instead of one, from their 25 kHz assignment, and either add more users to the system, or improve the chances that existing users will not get "busy signals," or both. In effect, more spectrum would be created—exploding the idea that the quantity of spectrum is immutably fixed. (See the articles on "Airwaves for Sale?" in this issue.)

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In Brief–

Endangered Species of the Month. The federal government has extended Endangered Species Act protection to *Potentilla robbinsiano*, a rare New Hampshire wildflower. It seems the hapless *P. r.* has the bad luck to grow only in the neighborhood of the Appalachian Trail, the federally maintained hiking path that runs from Maine to Georgia. Now, according to the *Wall Street Journal*, the plant is in danger of being trampled to extinction by nature lovers.

In Other Hiking News . . . Britain's Labour party drew up plans for a new "socialist countryside group" in a "bid for the 'green vote' " at the June election, the *Economist* of London reports. The group's probable chairman, Lord Melchett, called for legal changes to implement his rural environmentalism.

First on the list is "a law to allow people to walk anywhere they want in the countryside," in order to keep farmers from being beastly to wandering nature lovers who invade their property. Not only would hikers and suchlike get onto the property, but Lord Melchett wants to spare them unaesthetic sights once they get there: government planning boards would have to consent before farmers could erect new buildings, mow down hedges, or plant exotic trees on their land. Wouldn't that drive up the cost of farming? No problem: the Labour lord would make government grants available to small farmers who retain traditional farming methods instead of making improvements to the land.

Where America's Deregulation Begins? As an island strategically located in the western Pacific amid the rich markets of East Asia, the U.S. territory of Guam might be expected to be prospering like its neighbors. But instead it is stagnating and highly dependent on aid from Washington—and, according to an account by Stuart Butler of the Heritage Foundation, regulation is one big reason.

Many federal regulations are oddly inappropriate to Guam's remote tropical location (some find them oddly inappropriate here, too, but that is another question). The Environmental Protection Agency has told Guam that its oil-burning power plant must install a "scrubber," costing $20 million—that's $200 for every resident of the island—although almost all of the smoke is blown out to sea by trade winds. The Occupational Safety and Health Administration requires steel scaffolding on new construction, which not only corrodes in the tropical climate, but is much less safe in tropical storms than the indigenous bamboo scaffolding because it has less "give." The Jones Act requires that traffic from Guam to the U.S. mainland go in expensive U.S. bottoms. Minimum wage laws and prevailing-wage rules for construction have choked off a construction boom. (Happily, the Reagan administration recently waived the latter rule and substituted local wage councils; it has also established a task force on regulatory reform in the territories.)

The Guam tax code "mirrors" the Internal Revenue Code; all the money it raises there is remitted directly to the island government (along with a large supplemental payment). Many Guam businessmen would like to see the island's tax code revised to make it more competitive with its neighbors: Hong Kong's flat tax, for example, amounts to 15 percent for individuals and 16.5 percent for corporations. But so far Congress has not been willing to go along, nor has it shown much interest in Guamanian requests for regulatory relief. Perhaps it fears that the deregulatory impetus will spread to Hawaii . . . and then California. . . .

Baguettes Legalized in Walla Walla. The Washington state legislature has voted to give consumers half a loaf. It recently passed a bill to allow the marketing of bread in sizes half as big as the standard loaves mandated by previous state law (which had been, so to speak, Procrustean). The bill also legalizes the sale of odd-shaped French, Italian, and other so-called ethnic loaves. According to Representative Helen Sommers, the bread industry opposed more extensive decontrol, fearing that new entrants would get a slice of the market.

The FCC hopes that, by decontrolling technical standards in this way, it will give manufacturers of transmission equipment a greater incentive to innovate, since they will no longer have to convince the agency to change its specifications in order to sell a new product they come up with. The new licensees, for their part, have little to fear, since they are not obliged to buy new types of equipment. (Older parts of the land radio mobile spectrum continue to operate under the old rules.)

The FCC's new initiative is parallel in conception to the Environmental Protection Agency's "bubble" for airborne emissions. The "bubble" was begun in 1978 as a continuation of EPA's earlier "offset" policy, and has gradually been liberalized since then to permit, for example, trading of emissions rights among plants in the same area. Just as the plant managers have fixed limits on the pollutants that their plants can emit but latitude on how to apportion the permissible quantity among individual smokestacks, so mobile radio users can do as they please within their band so long as they avoid interference with other bands.

Both initiatives aim to let firms find, and take advantage of, their own opportunities for cost savings. Both resulted from dissatisfaction

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with "engineering controls" that mandated specific equipment and so discouraged the development of alternative pollution control and transmission technologies.

The FCC, however, has adopted its new policy with much less controversy and delay than EPA. The idea of the spectrum bubble was originated by an FCC staffer and encountered little opposition (mostly just mild objections from some equipment manufacturers who may have preferred the old system's predictability). EPA's emissions bubble, on the other hand, has run into resistance from the courts, environmental groups, some agency staff, and even some industry representatives.

There are a number of possible reasons why the FCC had it so much easier. First, its reform affects a very small group: the new licensees make up only a few percent of all mobile radio users. The EPA bubble has involved large firms like DuPont and millions of dollars.

Second, the FCC bubble is easier to enforce. Licensees still have to report what emission mode and bandwidth they are using, so that interference outside the assigned band is readily identifiable when the affected user complains. Any leeway in environmental regulation, on the other hand, rouses fears that harmful but unmeasurable emissions will occur while no one is looking. It also causes environmentalists to wonder why, if companies can reduce emissions further in certain locations at low cost, standards could not have been tougher in the first place. Contrariwise, industry has reason to fear that if it admits that these emission-reducing opportunities exist, enforcement personnel might call off the "offset" deal and instead order the reductions unilaterally.

Third, while both the spectrum and the environment are claimed as "public property," the spectrum, aside from its radio and TV segments, simply has not come under much scrutiny from the public or even, until lately, from economists. More important, the interference problem affects the same group of mobile radio users that benefit from the changes—that is, they collectively "internalize" their externality problem. There is no outside group, as there is in the case of the environment, that might suffer costs (real or imagined) as a result of the program that does not reap its benefits.

Fourth, because the FCC was drawing up rules for a newly allocated part of the spectrum, rather than for existing licensees, there was no major constituency trying to protect its investment in equipment, avoid new competition, or simply ward off change and uncertainty. All of these factors sometimes tend to make business dubious about market-oriented reforms.

The spectrum bubble shows that the reform ideas hatched during the last decade can help affect regulatory decisions even in far-flung fields, perhaps most effectively if they percolate up from the staff level. When EPA first drew up Clean Air Act regulations in the early 1970s, familiarity with these ideas had not yet filtered into policy-making circles. Now it has, and new regulations are showing its benefits—which does nothing, however, to ease the task of reforming old ones.

CAB + ICC + FMC = NTC?

When substantive regulatory reform is stalled, the thoughts of reformers turn to agency structure. To judge by the number of important reorganization proposals in the air right now, substantive reform is dead in its tracks. The Reagan administration wants to combine the Special Trade Representative's office and parts of the Department of Commerce into a new Department of Trade. Senator Daniel Patrick Moynihan (Democrat, New York) has introduced a bill to make the Environmental Protection Agency an independent instead of executive-branch agency. And—of perhaps keenest interest to regulatory reformers—Chairman Robert Packwood (Republican, Oregon) of the Senate Commerce Committee has introduced a bill (S. 48) to fold the three major transportation regulators into a single five-member panel.

The new National Transportation Commission would be an independent agency, like its three predecessors, the Federal Maritime Commission, the Interstate Commerce Commission, and the Civil Aeronautics Board (which is scheduled to disappear in 1985, most of its remaining functions going to the Department of Transportation). Perhaps its most salient virtue would be to help regulators address the growing trend toward "inter-modalism." Already, ICC rulings have made it easier for railroads to operate trucking firms, and some companies have found it profitable to pursue diversification even

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further: Tiger International, for example, carries freight by air and truck and leases rail cars. Critics have charged that the existing agencies promulgate inconsistent technical rules, ignoring the effects of their decisions on competing modes, or that two existing agencies both try to regulate a movement involving two modes.

Aside from making it easier to offer combined rail-truck service, Packwood's bill does not contain any substantive deregulatory reforms. It is premised on the view that, whatever reforms may take place in the next few years, transport regulation is not likely to disappear entirely. In the maritime area, for one, decontrol is nowhere in sight: in fact, Congress is debating whether to extend the scope of cargo preference laws. In air transport, federal intervention is likely to continue indefinitely on international routes, and even on domestic routes the 1978 Airline Deregulation Act guarantees "essential" air service to small communities through 1988, a provision that Congress could easily extend. In surface transport, the law continues to prescribe safety and insurance rules for truckers and rate ceilings for "captive" rail shippers (however those may be defined).

Those authorities still add up to a lot of power, even after scheduled deregulations are completed. But the existing agencies are becoming smaller and less prominent, which might conceivably make it harder to recruit commissioners who would be of high quality and resistant to "capture." A unified agency might attract prominent commissioners. On the other hand, each of the regulated industries involved would want to be represented on the commission, if only to contribute its specialized expertise. That would open up the prospect of anticompetitive logrolling among the airline member, the trucking member, and so forth—which might make for more efficient recartelization than the industries could ever have achieved separately. Logrolling of this sort, what one might call the dark side of inter-modalism, has traditionally been carried on between rail and truck interests at the ICC.

The new NTC might avoid capture, only to fall victim to a different danger: it might try to justify its existence by showing that economic regulation can be "done right." This "urge to meddle" (as Alfred Kahn calls it) might be suppressed if the new agency were made a politically accountable part of the executive branch (rather than an independent agency, as Packwood would like), so that its rulemakings were subject to oversight by the much-feared Office of Management and Budget, among others. The logical executive-branch home for the agency would be DOT—whose other parts, for what it is worth, are headed by single administrators rather than multi-member commissions.

But the old debate over whether it is more important to insulate regulators from political pressure or coordinate their actions with overall presidential policy is not likely to be settled any time soon. At any rate, the current organizational chart of the U.S. government does not conform to any set theory on the merits of executive branch versus independent status. Many sensitive quasi-judicial and adjudicative functions that no one would openly propose to "politicize" are now carried out by cabinet departments amid little controversy. For example, the Food and Drug Administration is part of the Department of Health and Human Services, drug approval powers and all. Meanwhile consumer safety education, a service activity one might think typical of the executive branch, is entrusted to the independent Consumer Product Safety Commission. Procedurally, executive branch agencies can adopt just as many quasi-judicial niceties as the independents: they can and do shield their officials from off-the-record contacts with the regulated, for example.

It would be impossible, even if it were desirable, to give purely adjudicatory functions to independent agencies and purely policy-making functions to executive agencies, since there is usually no clear line between the two kinds of function. In awarding an airline route, for example, the CAB is supposed to consider a long list of relevant criteria: fares, service, established position in the market, traffic "feed," and so on. But deciding how much weight to give each factor in a given instance is largely a policy

(Continues on page 50)

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AEI's Seventh Annual Public Policy Week will be held December 5–8, 1983, at the Mayflower Hotel, Washington, D.C.

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Viewpoint

Bruce Yandle

Bootleggers and Baptists–The Education of a Regulatory Economist

THE SEARCH FOR regulatory relief is as young as the Reagan administration, and as old as man. When the American Medical Association chafes under Federal Trade Commission oversight, it feels the same frustration Adam must have felt at the menu regulations he faced in Eden. But often people want relief not from regulation but through the protections regulation can provide. Today, some airline executives want succor from the uncertainties they confront in a world without regulated (uniform) pricing. The London weavers felt that same way about their trade in the thirteenth century and obtained relief through a provision in the Magna Carta requiring all cloth woven in the realm to be of uniform dimensions—conforming to the London standard. Nothing is new under the sun.

Economists from Adam Smith on (and including Karl Marx) have realized that government regulation is a sword that cuts in both directions, and all have called for reforms to improve the good regulations and prune the bad. But desiring reform and achieving it are obviously two different things. What we want to find out here is under what circumstances they can coincide. When can we achieve regulatory reform?

Regulation and Murphy's Law

In my studies of the relationships between governments and business, my attention was first attracted to the unbelievably costly things that governments do when attempting to control businesses. It seemed, as Murphy might have said, that if there was a wrong way of doing something, the regulators would adopt it. I found countless cases where rules and regulations imposed tremendous costs while delivering little if any benefit.

- Freight rates for one class of shippers were subsidized by another class of shippers. As a result, factories were located on the basis of false signals, real costs were hidden, and goods were shipped great distances at lower fares to be processed in higher-cost plants.
- Catalytic converters were installed on automobiles for the purpose of reducing emissions. But, for the converters to operate properly, unleaded gas had to be used—and it is more expensive than regular. So cost-conscious drivers put leaded gas in their tanks, which turned the converters into so much junk and added more emissions to the environment than there would have been had engines been even slightly modified or some other plan introduced.
- Petrochemical plants were required to reduce emissions at each and every stack by the same percentage. If instead managers had been given plant-wide targets and left free to attain them efficiently, the same degree of pollution control could have been achieved at much lower cost.
- Petroleum companies that found oil on Alaska's North Slope and sought to bring it to the lower forty-eight states by way of the West Coast were barred from doing so by complex environmental rules. Logic would then have dictated that the oil be shipped to Japanese refineries, which could have returned the refined product to the United States. But that was against federal law too. Instead, the crude oil

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is being shipped from Alaska to Texas, where it is unloaded and refined, all at considerable extra cost.

• Precise fuel economy standards were prescribed for automakers, to prod them into building the kind of cars that probably would have been produced and purchased voluntarily if the price of gasoline had been higher. But the price of gasoline was regulated so it could not rise; and the automakers had to ration their larger cars, which U.S. buyers wanted, while forcing smaller cars into the market. Eventually, the price of gasoline was deregulated and the effects of the mandated fuel-economy scheme tended to evaporate—for the time being, at least.

The list could go on and on. Not only does government rarely accomplish its stated goals at lowest cost, but often its regulators seem dedicated to choosing the highest-cost approach they can find. Because of all this, I and others in academia became convinced years ago that a massive program in economic education was needed to save the world from regulation. If we economists could just teach the regulators a little supply and demand, countless billions of dollars would be saved.

Bootleggers and Baptists

My views began to change after I joined the Council on Wage and Price Stability in 1976. There my assignment was to review proposed regulations from the Environmental Protection Agency (EPA), the Federal Trade Commission (FTC), the Department of Transportation (DOT), and parts of the Department of Health, Education, and Welfare (HEW). The field was white unto the harvest, and I was ready to educate the regulators. But then I began to talk with some of them, and I began to hear from people in the industries affected by the rules. To my surprise, many regulators knew quite a bit about economics. Even more surprising was that industry representatives were not always opposed to the costly rules and occasionally were even fearful that we would succeed in getting rid of some of them. It was in considerable confusion that I returned later to my university post, still unable to explain what I had observed and square it with the economics I thought I understood.

That marked the beginning of a new approach to my research on regulation. First, instead of assuming that regulators really intended to minimize costs but somehow proceeded to make crazy mistakes, I began to assume that they were not trying to minimize costs at all—at least not the costs I had been concerned with. They were trying to minimize *their* costs, just as most sensible people do. And what are some of those costs that keep regulators from choosing efficient ways of, say, reducing emissions of hydrocarbons?

• *The cost of making a mistake.* Simple rules applied across the board require fewer decisions where mistakes can be made.

• *The cost of enforcement.* Again, simple rules requiring uniform behavior are easier to monitor and enforce than complex ones, and they also have a false ring of fairness.

• *Political costs.* A legislator is likely to be unhappy with regulators who fail to behave in politically prudent ways—who fail, in the legislator's view, to remember the industries and the workers in his area.

Second, I asked myself, what do industry and labor want from the regulators? They want protection from competition, from technological change, and from losses that threaten profits and jobs. A carefully constructed regulation can accomplish all kinds of anticompetitive goals of this sort, while giving the citizenry the impression that the only goal is to serve the public interest.

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Indeed, the pages of history are full of episodes best explained by a theory of regulation I call "bootleggers and Baptists." Bootleggers, you will remember, support Sunday closing laws that shut down all the local bars and liquor stores. Baptists support the same laws and lobby vigorously for them. Both parties gain, while the regulators are content because the law is easy to administer. Of course, this theory is not new. In a democratic society, eco-

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nomic forces will always play through the political mechanism in ways determined by the voting mechanism employed. Politicians need resources in order to get elected. Selected members of the public can gain resources through the political process, and highly organized groups can do that quite handily. The most successful ventures of this sort occur where there is an overarching public concern to be addressed (like the problem of alcohol) whose "solution" allows resources to be distributed from the public purse to particular groups or from one group to another (as from bartenders to bootleggers).

... the challenges of regulatory reform are institutional.... The fact that a regulation has come into being as a result of a costly political exchange means that reform can hardly be gained easily.

What all this implies is that the challenges of regulatory reform are institutional. Regulation is relief for some and a burden for others, so that reform is a burden for some and a relief for others. The fact that a regulation has come into being as a result of a costly political exchange means that reform can hardly be gained easily. This is not to suggest that all is for naught, that there are no opportunities for reducing net (overall) regulatory costs or removing the protective regulatory cocoons woven so tightly and carefully around this activity and that. But it is to say that we can scarcely expect full-scale deregulation to occur often. Not when the Baptists and the bootleggers vote together.

Shocking the System: Pareto-Paperwork

Let us accept for the moment the proposition that all regulation produced in a given period has value at least sufficient to justify the direct costs borne by those supporting it. Since those who opposed a given regulation most probably fought it, rather than allowing it to proceed by default, we will *not* assume that the value of the regulation exceeds the total costs incurred by the winners, losers, and regulators.

Now consider an equilibrium state in which the political-economic market has produced a given quantity of regulation and will continue to maintain it unless there is an outside shock to the system. Imagine that you are regulatory czar, subject to all the economic forces at play in the system (other activities and actions being held constant) and with a free rein to reform the regulatory process. Finally, to make the situation more interesting (and more illuminating), imagine also that you are a long-suffering student of the regulatory system, with a long list of regulations you are convinced cannot be justified at all, or at least not in their present form. What would you do?

Regulatory paperwork would likely be your best candidate for reform—for it is an area where you might be able to reduce costs for both the regulated and the regulators (making both better off, no one worse off, in a kind of Pareto move), without disturbing the equilibrium state established by the interplay of rules and regulations. Of course, reducing paperwork is not nearly so dramatic as deregulating the airlines, speeding up new drug approvals, or removing import quotas (supposing any of these appealed to you). Still, it would not be a minor accomplishment. The cumulative savings from paperwork reduction for the years 1981 through 1983 are expected to reach 300 million hours. If you managed that as czar, we might well rise up and call your name blessed.

Unfortunately, other reforms would be much more difficult. Remember that you must act within the existing political forces, that the actors in the drama are all well-informed, and that the existing equilibrium is the product of a massive struggle.

Changes in the Demand for Regulation. So, let us ask, how might you upset that equilibrium by creating new players or causing the current players to acquire an interest in deregulation. Put differently, what factors might shift the demand for regulation?

- *Technological change.* A technology protected or even induced by regulation can nonetheless become obsolete, and the regulated businesses can find themselves hamstrung by the very rules that protected them.
- *Demographic change.* With migration and population growth, patterns of production and distribution supported by regulation can

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become so costly over time that the producer chooses to throw back the protective blanket.

- *Significant changes in factor costs.* Regulated firms generally seek regulations that fit production arrangements based on predicted prices for labor, materials, and capital—which means that unpredicted changes in those prices can alter the amount and incidence of the benefits of regulation.
- *New information.* With increasing scholarly and press attention to regulatory issues, voter/taxpayer/consumer groups might discover that their benefits from regulation are less than their costs.

Looking down the roster of successful regulatory reforms, it is not difficult to find cases that can be explained in part or as a whole by some combination of the above factors. For example, take the impact of technological change on the AT&T monopoly. Microwave, computer, and satellite technology outstripped the basic "hard-wire" systems used in Bell's telephone operations, creating competitive opportunities and weakening the demand for monopoly privilege. The field of action that had been created partly by inventions of the major telephone companies, yet barred to them, came to offer greater opportunities for growth and profit than the older regulated field. Technological change was also a crucial factor in banking and finance. The electronic transmission of funds, coupled with the Federal Reserve Board's dominant position in the check-clearing process, contributed significantly to a new technical base for financial institutions. This development, along with the unexpectedly high interest rates that commercial banks and savings and loans were barred from paying, made the old regulatory structure obsolete.

Changes in two other demand factors arguably undermined the traditional regulatory framework in trucking and other surface transportation. The unexpected increase in the price of energy magnified the costs associated with circuitous routes and empty backhauls, and changing population patterns made old route structures less desirable. Both developments fueled the demand for reform. Finally, take airline deregulation. In this case, it was rising energy prices, changing patterns of equipment utilization, and population shifts—combined with the development of new aircraft and intensive reporting of research on the effects of these changes—that shifted the demand for regulation.

As for future reforms, what might we predict on this same basis? Two come to mind. First, like AT&T, the U.S. Postal Service has stuck to an obsolete technology. With electronic transmission of messages, arguments about natural monopoly status have lost any credibility they may have once had and, for that reason among others, the statutes barring competition in the delivery of first class mail are under increasing fire. Energy regulation is another likely candidate for reform. Technical change and rapidly shifting relative prices have placed enormous pressures on existing regulatory structures, so that producers and consumers are now seeking greater flexibility than the present "public utility" status of much of the industry will allow. For example, the need for appropriate incentives to increase the amount of natural gas delivered to the market is widely recognized, and alternative systems for pricing and arranging the distribution of electricity are being explored. (Here, at least, we may have found one beneficial aftereffect of OPEC and its works.)

Changes in the Supply of Regulation. The supply side of regulation, like the demand side, helps determine the quantity of regulation produced in political-economic markets. Among the variables here are the bureaucracy and the electoral and legislative process.

- *Bureaucratic incentives and structure.* If lawyers and economists can improve their expected lifetime earnings by filing enforcement actions against specific industries, for example, those actions will tend to be filed. More broadly, how agencies are organized (whether they are independent commissions or headed by a single administrator), what voting rules are applied in making decisions, to what extent the agency specializes in an industry or product, and whether there is competition from other agencies for jurisdiction are traditionally thought to affect the supply of regulation.
- *Congressional oversight.* The legislative component of the supply side is closely related to demand, since elected officials also represent special interests who seek regulatory benefits. But, even so, the competition among legislators, their voting rules, and their committee organization are supply characteristics.

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Assuming that demand is held constant, to what extent will changes in these supply-side characteristics affect the quantity or quality of regulations produced? For example, will a reduction in the number of commissioners (as is happening now at the FCC), or a shift in the party mix of agency oversight committees, cause regulation to change?

Empirical research suggests strongly that the supply side matters. For example, Barry Weingast and Mark Moran report that, contrary to some opinions, the FTC's regulatory behavior mirrors the conservative-liberal makeup of the agency's key congressional committees: in other words, the agency is hardly ever "out of control" (*Regulation*, May/June 1982). Roger Faith, Donald R. Leavens, and Robert Tollison find that the FTC has been less likely to take actions against firms headquartered in the districts of congressmen who sit on the FTC's congressional committees than against firms not so favorably situated (*Journal of Law and Economics*, October 1982). My recent research on the FTC suggests that the agency's behavior is influenced not only by shifts in the chairmanship from a Democrat to a Republican and vice versa, but also by shifts in how the chairman is chosen (in 1950 the method was changed from rotation to presidential designation).

... there are strong possibilities for regulatory reform when the institutions involved are changing for other reasons. ...

Putting all this together, we may say that there are strong possibilities for regulatory reform when the institutions involved are changing for other reasons anyway. Such changes would help explain the flurry of deregulation initiatives at the FCC, especially those dealing with broadcasting, as well as the shift away from industry-wide rulemaking and structural antitrust investigations at the FTC. Moreover, the cautious attitude now shown by the Justice Department and the FTC when considering price discrimination, resale price maintenance, and vertical combinations, along with the probing economic analysis applied in such investigations, reflect new learning in law and economics and changes in the structure of the two agencies. Indeed, the significant overall reduction in new regulatory initiatives across the entire federal government reflects a coordinated effort that draws on each of the items mentioned.

Other Agents of Change

So far I have hardly mentioned yet another interest group: those who gain special satisfaction from participating in the regulatory process in ways that will improve economic efficiency. While some might conclude that students of the process can only observe, record, and analyze, I have a more sanguine view: simply put, people and their ideas do make a difference.

Some individuals, for example, make a difference by continuing to raise questions about grand principles—overall social efficiency, the appropriate role of government, economic freedom, the virtues of the price system. The more articulate and informed of these point out the compromises being made by the rest of us. Of equal importance are those whose goal is to understand how the regulatory process works, what interests are driving it, and how its outcome might be predicted. These are the academic researchers, the public policy analysts, the economists with private firms and in government, who struggle to bring about marginal adjustments. Their task is the creative application of economic logic. At yet a third level, there is active participation in decision making itself. When I observed the effect of an Alfred Kahn at the CAB, a Darius Gaskins at the ICC, and a James Miller at the FTC—to say nothing of the less visible but nonetheless significant work performed by scores of others in the arena where decisions are made—I must believe they make a difference, a very great difference.

Finally, one should not expect to see sudden and widespread transformation in regulation. Like all market processes, the market for regulation is relatively stable, the result of thousands of transactions and years of institutional development. Yet, also like other markets, the forces of supply and demand do change, and the agents for change can and do have marginal but significant impact on political demand and regulatory supply. Bootleggers and Baptists may have been agitating for a century or more, but the saloon is still with us—and usually on Sundays, too. ■

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AIRWAVES FOR SALE?

SOME THOUGHTS ON BROADCASTING REFORM

Kenneth Robinson

THE IDEA OF USING marketplace mechanisms to regulate the use of the radio frequency spectrum is not new. "Spectrum economics" or "selling the spectrum" has been a staple of the academic literature since at least the early 1950s when Ronald Coase and other Chicago School economists began to propound the idea seriously. What is new today, however, is the higher level of credibility and respectability it has recently attained.

There are several reasons for this. To begin with, the current regulatory regime governing access to and use of the spectrum is clearly showing its age. Its premises date from the 1906 Berlin Radio Conference, where the conferees placed great weight on order, predictability, and other familiar Prussian values. Maximum order would be achieved and chaos avoided, people thought, by neatly carving up the resource into orderly little blocks (allocations) and then requiring applicants for different kinds of radio service to compete only for channels in the pertinent block and, on getting them, use them only for the prescribed purpose. It was almost exclusively an engineer's approach, and in the telecommunications field, at least, scratch an engineer and you will probably find a closet socialist. Engineers, whether in 1906 or today, typically see redeeming value in "sound" centralized planning and give short shrift to intangible goals such as efficiency and flexibility in the programs they devise.

But if central planning and, above all, order are commendable or even achievable in markets characterized by stable demand and relatively stagnant technology, they quickly become unrealistic (at best) and genuine obstacles to progress (at worst) when both demand and technology advance exponentially. And that, of course, is what has happened in telecommunications.

Since the Korean War era, private and public demand for the radio frequency spectrum has approximately quintupled, as the spectrum has become an essential component of many production processes. On the private side, broadcast television, land mobile radio, and direct broadcast satellites are obvious examples of rapidly growing services that make intensive use of the radio spectrum. On the government side, the elaborate and costly communications systems needed to sustain federal public safety programs, air-traffic control, NASA "moon shots," and defense-related undertakings also

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place increasingly heavy demands on the radio spectrum.

This greater demand has put pressure on our traditional, neat, highly regulatory system of rationing radio channel usage. At the same time, advances in radio frequency engineering and associated technologies have made it technically feasible to meet the new demand by exploiting the spectrum far more intensively than we now do. But that requires, in the view of most reformers, the introduction of economic principles into the spectrum-rationing process, and changes of that magnitude come slowly because they alter the distribution of benefits among the players.

One example of this problem is the so-called ransom theory of deregulation, which has stymied broadcast reform for some time. All TV and radio broadcasters would like to be free of the comparative renewal process, and most seek general relief from their "public service" programming obligation as well. But key politicians will go along, if at all, only if the broadcasters agree to pony up large sums to pay for their use of the "people's airwaves." In previous deregulation cases, of course, the government had to pay certain stakeholders in order to facilitate procompetitive change. In rail deregulation, for example, industry's acquiescence was purchased by disbursing substantial amounts of federal funds to improve tracks and roadbeds and to place the Railroad Retirement System on a sounder footing. And both the Ford and Carter administrations' proposals for airline deregulation included employee retraining funds and money-saving concessions on environmental protection rules as necessary components of the package. But in the case of broadcasting, the ransom may come from, instead of go to, the industry.

Some Details

A good way to begin a discussion of spectrum economics is by briefly describing what this so-called invisible resource is, how we currently manage it, and what some of the more notorious problems are that we have encountered.

Back in the nineteenth century, European engineers, most notably the famous Mr. Hertz, discovered, first, that there are radio waves—electrical energy that has escaped into space—and, second, that these radio waves can be used to communicate. The chief characteristics of any particular radio wave are frequency or wave length (which vary inversely with each other: the frequency times the wave length always equals the speed of light) and intensity (which is a function of transmitter power, usually expressed in watts, and the distance between transmitter and receiver). What engineers consider the usable radio frequency spectrum is the range or band of frequencies from about 30 Hz (1 hertz is a cycle per second) to those in the order of 3 million MHz or 3,000 GHz (1 megahertz is a million cycles per second, and 1,000 MHz equals 1 GHz or gigahertz). Currently, the radio frequency spectrum is allocated from about 30 Hz to 300 GHz, although not all this range is used.

Within this very broad range of radio frequencies there are—by treaty—several dozen bands of frequencies, each with its own peculiarities and prescribed uses. As a point of reference, what is called the "standard broadcast" or AM radio band in the United States consists of the frequencies between 0.535 and 1.605 MHz. Conventional or very high frequency (VHF) television, by comparison, is assigned to two much higher bands (55.25 MHz to 83.25 MHz and 175.25 to 215.75 MHz). And microwave relay systems (which handle most long-distance telephone traffic) use channels in the 4 to 6 GHz range, again very much higher indeed.

In general, the higher the frequency, the more closely the signal takes on the characteristics of visible light. High-frequency services, such as conventional television or microwave relay services, thus tend to require line-of-sight signals that are susceptible to the same kinds of interference that affect visible light (raindrops, reflections, or dust, for instance). As a general rule, too, the higher the frequency range, the more sophisticated and expensive the radio equipment required. Citizens band (CB) radio, for example, operates on the frequencies from 26.9 through 27.2 MHz, and the equipment involved is priced in the hundred dollar range; "cellular mobile radio," by comparison, operates in the 800 MHz range and the equipment accordingly sells for a thousand dollars or more. Finally, the "bandwidth" that a particular service requires—that is, the swath of radio frequencies comprising a given communication channel—ordinarily varies directly with the

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amount of information to be transmitted. Radio communication is accomplished by varying the frequency according to how much information is sent. The greater the amount of information to be transmitted, the greater the number of frequencies needed, which is what gave rise to the term bandwidth. Audio transmission of ordinary voices or simple music, for example, involves much less information than does the transmission of a colored moving picture with synchronized sound track. Hence the bandwidth employed for a "broadband" service such as conventional television in the United States, for instance, is 6 MHz—a band encompassing 6 million waves per second—while that for AM radio is just 10 kHz (10,000 waves per second), or one-sixtieth as much. At higher frequency ranges, obtaining the channel space necessary to accommodate a broadband service is not a problem: the number of frequencies between 4.1 and 4.2 GHz is 0.1 GHz, or 100 million. At lower frequency ranges, however, the number of frequencies can be quite small: between 4.1 kHz and 4.2 kHz, for example, there are but 0.1 kHz or 100. Thus, if broadband channel requirements must be accommodated at lower frequency ranges—to keep equipment costs within reason, for example—there can obviously be far fewer available channels. (This, incidentally, goes far toward explaining the current level of concentration in the commercial television industry. More on that later.)

Economic Effects

If the engineering jargon and practices associated with radio frequency management are obscure (though orderly), the economic consequences for both industry and television consumers are not. Take, for example, the commercial television broadcasting system.

In 1952 the FCC, after years of debate, allocated two adjacent chunks of spectrum to VHF television services and subdivided the relevant spectrum block into twelve channels of 6 MHz each. It also devised criteria for separating the signals of stations transmitting on the same numbered or adjacent channels in order to minimize interference. Obviously, if two television stations were both to transmit on channel 4 in Washington, for example, not even the most sophisticated TV set tuner would be able to differentiate between the stations' signals. So, by FCC fiat, stations transmitting on channel 4 in the northeastern part of the United States are set at least 170 miles apart, and other mileage separation requirements obtain in other parts of the country.

What did the FCC achieve with its engineering decision? By allotting only so much spectrum to television, by requiring channels to be of a specified bandwidth, and by establishing mileage separation criteria, it fixed the total number of VHF television stations possible in any given locale and nationwide. In short, the FCC's decision limited entry into this most lucrative of all broadcast services and divided the country into an interlocking grid of shared monopoly markets.

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All this may have been justified in 1952, given conditions at that time. By 1972, however, when the old White House Office of Telecommunications Policy and the Justice Department's Antitrust Division urged new rules to accommodate up to 100 new VHF stations (the VHF drop-in proposal), many things had changed. Between 1950 and 1975, for example, the U.S. population had grown by 38 percent and gross national product by 430 percent (in constant dollars). In the same period, the Commerce Department's index of national advertising expenditures rose by 588 percent. Now, commercial television was already chiefly an advertising medium back in 1952, with its revenues and profits depending on the audience reached (plus the alternatives available to that audience). One does not need business school training to appreciate what the FCC's television engineering rules have done since then for industry profitability—or to understand why the National Association of Broadcasters objected so strenuously when the FCC finally agreed (in 1975) just to *consider* the VHF drop-in proposal. "Even *one* drop-in," said the NAB's filing with the FCC, "would be enough to undermine the Commission's successful television alloca-

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tion plan" (December 1977). In other words, just one more broadcast TV station would contravene what the industry called the "fundamental laws of physics."

Strangely enough, those fundamental laws of physics do not obtain in Japan (which uses almost the same TV transmission system we do, a heritage of the MacArthur era). Japan is a country of about 145,000 square miles, one-twentieth the land mass of the United States. In 1978, it used only about 264 MHz of spectrum, divided into twelve VHF and thirty-two UHF channels, to distribute television programming through a total of some 7,300 broadcast TV stations. Of that number, 212 were the full-service variety prevalent in the United States, and the balance were relay outlets. By comparison, in the United States that year, the FCC allocated 408 MHz of spectrum, divided into twelve VHF channels and fifty-six UHF channels, to provide broadcast TV through some 1,000 full-service stations (600 VHF and 400 UHF) and 3,000 relay or translator outlets. And in California, which is 10 percent larger than Japan, FCC regulations allowed just 66 full-service and 349 translator stations. So much for the fundamental laws of physics.

Ultimately, of course, the opponents of additional TV stations had to give way—partly. In 1980 the FCC accepted a drastically limited version of the drop-in plan, approving only four new stations and opening the way for perhaps a few more. About the same time, it also established a new class of low-power TV stations.

For another example of delay and interest-group maneuvering, consider the saga of cellular mobile radio, one of the most protracted government endeavors since Mao's "Long March." Cellular mobile radio, which was developed by AT&T and Bell Laboratories, is a type of high-capacity mobile telephone service that uses many computer-controlled, very low-power transmitters to multiply by many times the number of telephone channels available for use in a given locale. The technology is extraordinary—so extraordinary, in fact, that it troubled the stakeholders. A local radio-telephone service of this sophistication poses a potential threat to the traditional hard-wire services that AT&T and others provide. It also might compete with the established radio common carriers that sell paging and conventional mobile telephone services, while, at the same time, diminishing demand for purely private, user-run mobile systems (a matter of some interest to the dominant manufacturers of equipment for such systems, which include Motorola and General Electric). Finally, the new public demand for cellular mobile radio would in all likelihood stimulate competitive entry into the radio equipment manufacturing business. In short, all the stakeholders stood to suffer—except for the public and the Japanese—from the introduction of "too much" cellular radio "too fast."

The FCC first called for comments on how best to develop cellular services in July 1968. This was only the beginning of a regulatory and appellate story whose legal chapter was not closed until this spring and which, considering the number of applications and competing applications now pending at the FCC—some 6,000 at last count—may well never be completed. While estimates vary, most observers expect—or once expected—the industry to generate profits of at least $1 billion annually. Yet for fifteen years, the advent of this potentially highly valued service was blocked by a combination of rigid regulatory procedures and well-paid, imaginative communications lawyers.

What's to Be Done?

Given the frustrations and economic inefficiencies inherent in so much of the prevailing frequency management, lawyers and economists have hypothesized a number of alternatives. To minimize licensee selection delays, Congress has authorized (but the FCC has not yet used) both straight and weighted lotteries. More ambitious schemes would have the government simply selling off chunks of spectrum to the highest bidder, as the Interior Department does periodically with oil-drilling leases and grazing rights to federal lands. While there is not yet a consensus on which option should be pursued, here are the chief "principles" or considerations that have been explored.

Spectrum Fees—Small and Large. First, of course, there is the proposal that, for want of a better term, both the Carter and the Reagan administrations have labeled the "equity principle"—namely, that in the interest of fairness,

(Continues on page 47)

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AIRWAVES FOR SALE?

SPECTRUM FEES VS. SPECTRUM LIBERATION

Milton Mueller

FOR MORE THAN FIFTY YEARS, the right to broadcast on a particular frequency has been considered a privilege, not a property right. In exchange for a license giving exclusive use of a channel, broadcasters have been required, among other duties, to air a specified amount of religious, educational, and public affairs programming and to ascertain the needs of their audience through interviews with "community leaders." The constitutionality of this exchange was decisively upheld in 1943 when Chief Justice Felix Frankfurter, speaking for the U.S. Supreme Court, wrote that the "fixed, natural limit upon the number of stations that can operate without interfering with each other" justified Congress's decision to impose the responsibilities.

If Frankfurter's "fixed, natural limit" was ever strictly valid, it is plainly at odds with reality today. Refinements in electronics allow us to squeeze more and more information into a given bandwidth without interference. New distribution technologies have arisen that either use new bands of the electromagnetic spectrum (as do direct broadcast satellites) or avoid using the spectrum altogether (as does cable). Broadcasting is now just one segment of an integrated and highly competitive telecommunications environment. "Scarcity" continues, as it does everywhere in the economic realm, but "fixity" is no more.

As the broadcast market becomes more like other markets, the "public trustee" model of regulation is slowly giving way to a successor. Chairman Mark Fowler of the Federal Communications Commission (FCC), a former broadcaster, rather prosaically calls it "the marketplace approach." Others, like Senator Robert Packwood (Republican, Oregon), compare broadcasters and cable services to "electronic publishers" who should enjoy exactly the same freedom from government control as the print media.

Whatever its name, implementation of the new approach would require a top-to-bottom overhaul of the regulatory framework of the 1934 Communications Act. And by now, the forces of change are already straining at the limits of that law. For several years the FCC has been hacking away at its regulatory thicket, eliminating paperwork, lowering barriers to entry, easing content regulations and ownership restrictions. All this has been done on its own administrative discretion, however, which

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means the reforms could be reversed by a subsequent commission. Only statutory change can eliminate this source of uncertainty and push deregulation further.

Thus the responsibility for reform now falls on Congress. Except in 1981, however, when the Senate and the House passed a minor law extending radio and TV license terms by a few years, they have been unable to get together on broadcast deregulation. Variations on a proposal introduced by Senator Packwood have passed the Republican Senate three years in a row, only to die each time in the House Energy and Commerce Committee's telecommunications subcommittee. The senator's latest attempt is S. 55, a bill that would codify the FCC's deregulation of radio and eliminate the comparative aspect of broadcast license renewal. S. 55 passed the Senate in April but has been holed up in the House subcommittee. Representative Timothy Wirth (Democrat, Colorado), who chairs the subcommittee, believes TV is not competitive enough to be deregulated, and has his doubts about radio too. Representative John Dingell (Democrat, Michigan), chairman of the full committee, adds that deregulation gives broadcasters "exclusive and highly profitable use of a scarce and valuable resource [the channel] in perpetuity without any accountability." "Where," he asks, "is the quid pro quo for the public in that arrangement?"

The old "quid pro quo," of course, was the broadcaster's "public service" obligation. But although the rationale for this obligation is unraveling, Congress seems unwilling to let it go without substituting something else—much like the French kings who consented to free the peasants from the forced-labor corvée only if it were commuted to a plain money tax. In the case at hand, the price broadcasters would pay for their freedom would be a "spectrum fee" for the exclusive use of a frequency or channel.

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As Henry Geller, former head of the National Telecommunications and Information Administration (NTIA), puts it, the proceeds could be funneled to "services which under the present scheme were to be part of the radio broadcaster's quid pro quo"—that is, public radio broadcasting for educational and cultural programming and minority radio ownership for programming diversity.

The idea of a spectrum fee/deregulation trade-off dates back to 1978 when former Representative Lionel Van Deerlin (Democrat, California) unsuccessfully attempted a comprehensive rewrite of the Communications Act that would have given broadcasters their licenses in perpetuity and freed them from the equal time and fairness rules in exchange for a fee. The fees, ranging from 0.25 percent of the smallest stations' revenues to a whopping 25 percent of the largest, would have been plowed into a fund to support public, educational, and minority programming. Broadcasters hated the idea.

But although Van Deerlin left Congress not long thereafter, his idea had staying power. The National Radio Broadcasters Association (NRBA), impatient for statutory deregulation, came up with a proposal to have radio stations pay from 0.25 to 1 percent of their gross revenues to public broadcasting in exchange for legislation that would lift all radio regulations (except for the equal time and fairness rules, which, not so incidentally, guarantee elected officials access to broadcast time). Had this scheme been implemented in 1980 and applied to television as well as to radio stations, it would have generated $210 million. Last September, in a speech before the NRBA, none other than Chairman Fowler himself endorsed the concept of a fee/deregulation trade-off.

Fees of a very rudimentary sort are already included in S. 55. This bill would charge radio broadcasters $1,200 for a license application and $6,000 for a hearing, a charge intended to cover the costs of processing. In April Wirth outlined his own fee idea, which would cover radio (but not TV) broadcasters. It would give the former a lot for their money: repeal of equal time and fairness "in all but the smallest markets," elimination of comparative renewals, "*long* term license stability, not just seven-year, ten-year, or fifteen-year terms," and statutory codification of the FCC's 1981 rulemaking lifting most content regulations on radio.

Unlike the NRBA, the powerful National Association of Broadcasters (NAB) is unwilling to support any fees beyond those needed to de-

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fray the costs of administering regulation, as in S. 55. It sees scarcity-based fees as simply a "tax on broadcasters" that could be raised at any time. And public broadcasting, it believes, should be funded from general tax revenues. So the NAB has been trying to circumvent Wirth's subcommittee by attaching deregulation measures to an FCC authorization bill.

The Economics of Spectrum Fees

On the surface, fees look like the type of market-oriented device economists like, a sort of price system in miniature. They have the appearance of a tax on "rents," which economists often like to think is the sort of tax that avoids distortion of the marketplace use of the good that is taxed. Nor would there seem to be equity objections: having received something as valuable as a broadcast license, the theory goes, broadcasters ought to pay for the privilege. After all, if licenses were auctioned off they would bring prices ranging up to the hundreds of millions.

But it turns out to be difficult to come up with any actual charge structure that simulates the real-world qualities of a price system. Spectrum fees could certainly succeed in raising revenue, but at the cost of misallocating spectrum resources and raising severe equity questions. Because the fees would have to be set in advance, using an essentially arbitrary formula that would be hard to change with economic conditions, there would be, at best, only rough correspondence between the size of the fee charged and the economic value of any particular channel. This uncertainty means that unless a fee formula is set very low it will drive some low-budget operators out of business, especially in rural areas.

There are two possible kinds of formulas. The type of fee FCC Chairman Fowler seems to favor would be based on how much spectrum a broadcaster uses. The type of fee that Van Deerlin and the NRBA proposed would be based on a broadcaster's revenues or audience size.

Quantity-of-Spectrum Fees. The Fowler type of fee would require spectrum use to be quantified as a function of bandwidth, area covered, time, and power density. Unfortunately, no one has ever come up with an adequate unidimensional measure of the dimensions of the spectrum. Unlike land, oil, or beef, which can be measured in terms of a single unit like weight or area, the dimensions of the spectrum are incommensurable. There is, in other words, no way to compare various combinations of bandwidth, geographic scope, and time fairly. Some observers refer to the spectrum as a "five-dimensional resource," counting the three spatial dimensions plus time and bandwidth. One engineer—not to be outdone—found no fewer than *eight* different "dimensions" by including such factors as polarity.

There is, in other words, no way to compare various combinations of bandwidth, geographic scope, and time fairly.

In fact, the spectrum is better compared to a right-of-way than to a pool of oil or field of wheat; one use does not always preclude other uses. The appropriate market price would be determined not by how much spectrum is "occupied" by the user, but by which alternative uses for the channel he crowds out. No fixed engineering standard can establish that; it depends on who else in the area would like to use the channel at a given time and whether uses are entirely incompatible—a condition that changes as technology changes.

Finally, the economic value of a channel has little to do with the power or bandwidth used. A rural station may require a powerful transmitter to reach a few thousand people, while a low-power station in New York City may reach millions. The logical implication is to base fees not on technical characteristics but on audience size.

Fees Based on Revenues or Market Size. Formulas based on a station's revenues or potential revenues (market size), however, discourage optimal use of the spectrum because they penalize those who use it most efficiently. An AM radio station occupies only 10 kHz, while an FM station takes up 2 MHz, or 200 times as much bandwidth. (The added versatility that comes with the extra bandwidth makes FM even more valuable.) Yet an FM station's revenues (and thus fees) may be lower than those of an AM competitor.

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Moreover, as Fowler has rightly noted, if the spectrum fee idea is valid, it should apply to *all* spectrum users, not just TV and radio broadcasters. But here is where the real bureaucratic nightmare begins. It may make some sense to set fees by comparing two television channels with each other, or by comparing the revenues of a VHF-TV broadcaster with a UHF competitor or even a radio station. But what about the businesses that use the radio spectrum—telephone companies, paging services, taxicab dispatchers, and many others? What about a cable system that retransmits broadcast signals for profit—should it pay too, and how much? When AT&T routes a long-distance call over both radio and other lines, how much of its revenues from the call should be attributed to spectrum use? Since the fee structure would have to be based on massively simplified assumptions, it could very easily encourage misallocation of spectrum.

In support of their advocacy of fees, proponents cite analogous "user fees" in other areas. But their examples are not reassuring. Daniel Brenner, legal aide to Chairman Fowler, has likened the fees to a charge per axle on toll roads—and axle charges have been found to be a bad proxy for the actual damage trucks do to roads. To the extent that spectrum fees would not be strictly proportional to the economic value of a license, they would not be "user fees" at all but just plain old *taxes*, and distortive ones at that.

To the extent that spectrum fees would not be strictly proportional to the economic value of a license, they would not be "user fees" at all but just plain old taxes. . . .

The Market Alternative

Of course, if every broadcast station changed ownership every week, the value of every license could be estimated with satisfying accuracy, for the purpose of assessing fees. The trading price would reflect the true scarcity of broadcast licenses because it had arisen from actual market exchanges, and it would *automatically* express and respond to changes in supply and demand. But the station "price" implicit in formula-based fees would not change automatically—and even if it did it would still be impossible to compare radio and TV frequency prices fairly with prices for other parts of the spectrum, because spectrum cannot now be transferred from one use to another.

More fundamentally, there is no reason why the market itself should not be allowed to define and create new channels.

This brings us to the underlying problem with all of these schemes, which is that the FCC would continue to allocate particular frequency bands to specific uses, define what is a "channel" for each band, assign these channels to applicants, and thus limit the total number of users. This is the real flaw in the system. The FCC has begun to address the problem with its decision to "drop in" new FM stations, and with any luck it will also drop in VHF stations or even revise its assignments entirely to make room for newcomers in the largest markets.

More fundamentally, there is no reason why the market itself should not be allowed to define and create new channels. The best way of doing this would be to give existing spectrum users full property rights, letting them resell and subdivide channels freely and reach agreements on interference with neighboring stations. The FCC's role would be reduced to guaranteeing a certain measure of noninterference in cases where adjacent stations had reached no such agreements.

Quid for What Quo?

What about the equity arguments for fees? These, too, may seem compelling at first glance. TV stations in major markets are being sold at prices of more than $200 million. In 1982 alone station trading reached a total of $998,398,000, and since 1954 it has added up to $8.7 billion. Everyone knows that station equipment accounts for only a tiny portion of those prices. Most of the rest represents the value of the exclusive licenses.

The temptation, then, is to tax away some small share of this large windfall. The problem

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is that in most cases the windfall was long ago captured by the original licensees. License holders who bought their licenses from earlier holders at market rates have no "windfall" to tax.

There is a legitimate distinction, however, between the portion of license value that derives from genuine scarcity and the portion that derives from the FCC's restrictive frequency allocations. The way to benefit consumers is not to divert this monopoly capitalization to the government's coffers, but to do away with it entirely by opening up the market. To the extent that licensing creates *artificial* scarcity, the market prices of frequencies are like truckers' operating rights; and having the FCC charge for their monopoly component is no more of a solution than it would be in the trucking case.

What about Public Obligations?

Some of the broadcasters' "public-service" obligations, like the obligation to provide news, are voluntarily fulfilled in large quantity by the market. Others, it is argued, must be provided by public broadcasting. Even FCC Chairman Fowler, often accused of excessive reliance on the marketplace, thinks an unregulated market would fail to provide adequate programming for children and the elderly, presumably because these audiences do not appeal to advertisers.

But this conception of the "marketplace" is too narrowly economic. Many noncommercial institutions, including several important magazines, thrive in our commercial culture with neither financial profits nor government support, relying instead on outside support. Deregulation does not mean turning all stations into commercial enterprises. Simon Geller's one-man classical radio station in Massachusetts was not a "commercial" operation—which did not prevent the current regulatory regime from taking away its license and turning it over to a large, commercial enterprise.

Here again the fee proposals fail to get to the root of the problem. The conditions that led to the establishment of public broadcasting are changing. The new technologies, not least home recording, are segmenting the market into special interest groups capable of sustaining programming for minority audiences without advertising. There are already many cable and satellite programming services that specialize in such offerings as news, Spanish-language programming, weather, the arts, and children's fare.

The needs once addressed by public broadcasting subsidies would be best met by the kind of deregulation that would make telecommunications as open and accessible as the print media, not by creating a subsidy fund to insulate public broadcasters from the realities of public choice. Opening up the allocation of spectrum, the use of satellite transponders, the franchising and interconnection of cable systems, and the entry of telephone companies into the market would have a lot more impact on our future information diet than boosting the budget for the Public Broadcasting Service.

At the same time, public broadcasters themselves should be freed of federal restrictions. They should be allowed to sell ad time if they wish. They should also, as the Temporary Commission on Alternative Financing for public broadcasting recommended in July 1982, be allowed to raise money by leasing their excess satellite capacity and by letting unused bits of spectrum be employed for data transmission and similar uses (a process that has already begun).

But as the NTIA has noted, public broadcasting may also have to start economizing on its services, if only by lessening the enormous amount of signal overlap in the system. Of the 288 public stations, 184 overlap in signal coverage by 50 to 100 percent. Thus in Washington, D.C., viewers can tune in four different public channels whose programming is duplicative much of the time.

The Politics of Fee Proposals

The important and often overlooked question is: how much do broadcasters really *want* to be deregulated? Unlike the airline and trucking industries, broadcasters have seized on the term "deregulation" as their own; but the cases may not be that different after all.

The National Association of Broadcasters opposes freeing up the spectrum; in fact, there is some question as to whether the broadcast industry would even like to get rid of all of its traditional "public trustee" obligations. Those

(Continues on page 52)

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Repealing Rules

James V. DeLong

FOR ALMOST FIFTY YEARS regulation has tended to be a one-way ratchet. In discussions of regulatory policy, the question has almost always been whether to impose additional controls over some area of national life, and only rarely whether regulations should be eliminated.

In the last few years, the dialogue has begun to change, as unease about the underlying premises of the regulatory state—about not just its economic efficiency, but its social efficiency and moral legitimacy as well—has affected the academic and intellectual communities. As Harvard's President Derek Bok recently stated,

> judges, lawmakers, scholars . . . need to search for a new understanding that is no less sensitive to injustice but more realistic in accounting for the limits and costs of legal rules in ordering human affairs. . . . Lacking such a vision, judges and regulators will continue to drift toward a general willingness to intervene whenever they feel that one person has suffered at the hands of another. . . . What emerges from this process is a spurious form of justice. . . . [T]he law may seem enlightened and humane, but its constant stream of rules will leave a wake strewn with disappointed hopes of those who find the legal system too complicated to understand, too quixotic to command respect, and too expensive to be of much practical use [*Harvard Magazine*, May/June 1983].

James V. DeLong, now a Washington attorney, formerly was research director, Administrative Conference of the United States.

The current administration took office with the announced intent of reducing regulation, but it has not been easy for it to find reverse gear on the regulatory machine. Relatively few repeal efforts have been carried through to completion and, of those that have, several have not survived the courts. In the most notable of these, a case now awaiting review by the Supreme Court, the U.S. Court of Appeals for the District of Columbia reversed the decision of the National Highway Traffic Safety Administration (NHTSA) to repeal its rule requiring passive restraints in cars. But this is not the only example. The same court also nullified the repeal by the Civil Aeronautics Board (CAB) of its rule on smoking in airplanes, and district courts have invalidated both the Department of Labor's attempt to revise the regulations under the Davis-Bacon Act and the Treasury's reversal of position on its final, but not-yet-effective, requirements for ingredient disclosure on alcoholic beverages. (See page 29.)

The decisions have not gone all one way. The Federal Communications Commission (FCC) has been upheld in a number of deregulating actions, as has the Interstate Commerce Commission, and there may have been other revocations which did not arouse enough controversy to reach either the courts or the newspapers. Nonetheless, it is clear that, barring an unlikely Supreme Court decision giving agencies a blank check, this administration or any other that is interested in deregulating must approach the issues surrounding repeal systematically.

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The Rules on Repealing Rules

On the surface, this does not seem to present any particular problems. The starting point is the recognition that current law provides no special track for revocation. The statutes governing rulemaking procedures include the unmaking of rules within the general category of rulemaking, so the basic process is the same in both cases. At a minimum, repeal requires an agency to publish a notice of proposed rulemaking, collect public comments and, in the end, accompany any final rule with a statement providing a rational explanation of the reasons for its action. If the statute that governs rulemaking in a particular area requires an agency to follow more elaborate procedures—oral hearings, for example—this will apply to revocation as well.

Nor is there any special track for judicial review of repeal. Under the statutes, a court will reverse the agency if its action was not in accord with its legal authority or if it was "arbitrary." In addition, many of the more recent rulemaking statutes expand judicial review to require courts to reverse the agency if its action is not supported by "substantial evidence." This term is ambiguous enough in the normal context of rule promulgation, and its meaning in the context of repeal is anyone's guess. The safe approach is to read it as requiring the agency to take cognizance of available empirical evidence.

The second crucial point about repeal follows from the first. Given that the agency must provide a rational explanation for an action and must in some cases support that explanation empirically, it is necessary for the agency to think through exactly why it *has* decided on revocation. The number of possible reasons is not infinite, and the following taxonomy of possibilities may be complete:

- *Change of circumstances.* The rule may have done its job and no longer be needed, or may otherwise have been made obsolete by events. Whatever the reason, the agency decides that the conditions that brought forth the rule no longer exist and, therefore, neither should the rule.
- *Failure.* The rule is not achieving its intended purposes and the agency believes that either a new approach is needed or the purposes must be given up.
- *Side effects.* The rule has unanticipated or excessive consequences of some kind, unrelated to the original purposes, that outweigh any benefits.
- *New knowledge.* The rule was premised on particular scientific, technical, or even legal assumptions that have since been refuted or rendered less certain than they were originally thought to be.
- *Original sin.* On reexamining the original record, the agency finds that its initial decision was not justified by the information available. This can take many forms, and is of course most likely to occur after a change of personnel. The new team decides that its predecessors misjudged the reliability of the data, or drew erroneous conclusions from it, or made some other technical error, or that that rule was in some other way flawed from the beginning.
- *Change of philosophy or policy.* This, again, is most likely to occur after a change of personnel, especially one following a shift in administrations. The new officials believe that the original decision represented a mistaken policy and that even in the absence of new information it should be reversed. This category could encompass some of the preceding ones, of course. A change in policy could include a change in the evidentiary standards to be applied to agency records. (See Timothy J. Muris, "Rules without Reason at the FTC," *Regulation*, September/October 1982.) Or it could ascribe great importance to certain side effects that a previous administration chose to ignore. The category could also include a reassessment of redistributions in favor of particular constituencies. It is unlikely, for example, that a Republican Department of Labor will regard labor unions with the same smiling countenance as will a Democratic one.
- *Broad philosophy.* All of the considerations cited above involve an agency's stance vis-à-vis a discrete rule. It is also possible for the government to take a broader view, akin to that expressed in the quotation from Derek Bok. It could believe that the crucial scarce resource is public understanding and acceptance of regulation, not just dollar costs, and that the necessary analysis is whether a particular regulation represents a good use of that resource. In a government that seems to be leaking legitimacy from every pore, this may be no small consideration.

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The third point about repeal involves the application of these reasons. In theory, this is not a difficult task. The first five of the reasons, at least, are firmly anchored to the original purposes of the rule and involve technocratic considerations that will usually be susceptible to coherent factual explication. The last two, while more political, seem to be covered by the fundamental rule that an agency is operating with maximum discretion when it is making "policy choices" and that a court will rarely reverse an agency decision in this area.

The Default Drive

Finally, one must throw in a factor that is easy to forget, especially if one lives in Washington. Regulation is not a process by which the government creates order out of some primeval chaos. There are functioning nongovernmental decision processes in the form of the market, the common law, voluntary associations and standards, collective bargaining, and other private mechanisms. It is in fact an assumption of our political system that most of our national life should be governed by these processes—they are the "default drive," in current computer language. Regulation should be an exception, used only when these processes are for some reason inadequate or when they need government bolstering.

In consequence, a decision to repeal a rule does not necessarily mean that the result mandated by the rule will not or should not occur; it means only that the question will be returned to these other decision processes. Some good examples are given by the repeal cases that have come before the courts. Even in the absence of NHTSA's air-bag rule, consumers might demand passive restraint systems if insurance companies provided big enough rate incentives or if common law courts classified failure to wear seat belts as contributory negligence and barred recovery of damages by anyone injured as a result. Even without the FCC rule setting a maximum on how many minutes of commercials radio stations can broadcast per hour, stations will not broadcast sixty minutes' worth; rather, many of them will compete for listeners by boasting how few commercials they run. Even if the appeals court upholds the Treasury's revocation of its labeling rule for alcoholic beverages, that would not forbid labeling; it would simply turn the decision on that matter back to the market.

This factor is important because it implies that a rule should carry a continuing burden of justification. The question is, "Knowing what we know now, would we pass this rule?" If the answer is "no," then repeal is in order.

Application of this sort of presumption against regulation would make repeal considerably easier than it would otherwise be. It would limit the scope of inquiry in two important ways:

- First, most rules depend on a chain of reasoning each link of which is necessary to the final result. If the burden is on those who want to continue regulating, then a break in any of the links justifies repeal. So an agency could conduct a proceeding to analyze the questionable link alone. It would not have to replicate the entire initial effort—though, of course, it might have to look at the extent to which private parties had changed their positions in reliance on the rule. If the procedural requirements are complicated, this could make a considerable difference.
- Second, in any rulemaking much of the time and effort goes into an initial broad sweep for possibly relevant information and analysis, and an initial sorting of this material. If a repeal proceeding uses the results of this as a starting point, the agency is automatically far along the rulemaking road.

This schema is straightforward enough, and, if it holds, the only real requisite for future repeal efforts would be that the agencies get better organized to articulate and support their positions. It would not allow them to repeal regulations summarily on the ground that they offend the politically powerful, but they are not supposed to do this anyway.

A Right to Regulation?

However, it is not clear that the schema will hold, because the repeal cases—and this is one of their most interesting aspects—exhibit a somewhat different view of rulemaking. They do not presume that nonregulation is the default drive. Instead, they seem to assume that there may be a privately enforceable right to regulation and that, at best, consignment to the

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The Track Record on Repeal

Among key recent cases in which courts have entertained challenges to the repeal of rules are:

FCC v. WNCN Listeners Guild (1981). In 1976, the FCC said it would no longer review changes in entertainment programming when considering applications to renew or transfer radio licenses, and argued that market forces would promote the diversity needed to protect the "public interest." (See "Reversing the D.C. Circuit at the FCC," *Regulation*, May/June 1981.)

The Supreme Court found that the FCC's explanation was adequately "reasoned" and its decision to rely on the market did not violate the statute.

NAACP v. FCC (1982). In 1964, the FCC announced it would not approve applications to buy TV stations in one of the top fifty markets without holding an evidentiary hearing on the issues. In 1979 the commission revoked this policy on the grounds that its fears of undue concentration had been exaggerated and that other multiple-ownership rules were sufficient to deal with any problem.

The D.C. circuit court upheld the decision, finding that the agency had adequately supported its conclusions and rejecting the plaintiff's argument that the agency had the burden of proving that "no harmful effects would flow from repeal." The agency's obligation was simply to attempt to have all views represented, not to seek out all available information, and plaintiffs could have introduced information on harmful effects if it existed.

Office of Communication of the United Church of Christ v. FCC (1983). This case involved a three-year rulemaking which ended in the "sweeping deregulation" of the commercial radio industry. Although the FCC rejected a totally market-oriented approach, it substantially relaxed requirements on nonentertainment programming, public-interest programming, and minutes per hour of advertising. It also eliminated the requirement that stations maintain program logs. (See "Radio Deregulation: Stay Tuned," *Regulation*, March/April 1981.)

The D.C. circuit court upheld all these actions but the last.

State Farm Mutual Automobile Insurance Co. v. Department of Transportation (1982). The air-bag controversy has become one of the great symbolic issues of regulatory politics. Under President Carter, NHTSA—after twelve years, sixty different *Federal Register* notices, two court of appeals decisions, and innumerable congressional interventions—promulgated a rule requiring automakers to install either air bags or automatic seat belts in their new cars. In 1981, after the rule had become final but before it had actually taken effect, NHTSA repealed it. The agency's reasoning was that most automakers would comply with the rule by using automatic belts that consumers could easily undo, that the costs of the restraints would be justified only if they raised seat-belt usage from its current level of 11 percent to at least 24 percent, and that the earlier predictions of such an increase were unreliable. (See "Active Judges and Passive Restraints," *Regulation*, July/August 1982.)

The D.C. circuit court reversed, primarily on the ground that—given the existence of the rule—the issue was "not whether evidence shows that usage rates will increase . . . but whether there is evidence showing they will not." The agency could not rest its decision on the uncertainty that the increase would in fact occur. In addition, the agency had not met its obligation to consider alternatives other than total repeal.

Center for Science in the Public Interest v. Department of the Treasury (1983). In 1980 the Treasury Department published a rule, effective January 1, 1983, requiring that liquor labels contain either a list of ingredients or a statement on how to obtain such a list. In 1981 the agency rescinded the rule with a two-paragraph notice to the effect that benefits did not justify the increased costs to industry and to consumers in general, and that the rule was incompatible with Executive Order 12291 and with international obligations.

The D.C. district court found itself "required to reject agency actions such as this which are ill-considered and superficially explained."

Action on Smoking and Health v. CAB (1983). The CAB started regulating smoking on airlines in 1973 by requiring separation of smokers and nonsmokers. In 1979 it also required that airlines accommodate all passengers desiring a no-smoking seat, that smoking be banned when ventilation systems were not functioning properly, and that cigar and pipe smokers be specially segregated. In 1981 the board rescinded the ventilation and pipe-and-cigar provisions, and allowed airlines to condition their guarantee of a no-smoking seat on receiving some reasonable pre-boarding notification.

The court reversed the action on the ground that the agency had not explained it adequately.

Building and Construction Trades Department, AFL-CIO v. Donovan (1982). This case involved the Department of Labor's attempt to change some of the definitions in the Davis-Bacon Act.

The D.C. district court found, with one exception, that the former definitions, which had been applied for almost fifty years under eight presidents and fifteen secretaries of labor, represented the correct interpretation of the law, and that the department did not have the authority to change them.

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nongovernment decision processes of society is an option that stands on the same footing as regulation.

This view is especially noticeable in the passive restraints opinion. While Judge Mikva did not articulate the matter this way, his long discussion of the congressional history of passive restraints can be read as an inquiry into what presumptions Congress intended NHTSA to apply. Looked at from this perspective, he concluded that Congress intended the nonregulation option to be a last resort—the agency could reject regulation in the passive restraint case only after examining and refuting all reasonable affirmative options.

The same concepts run through some of the other cases as well, including those in which agency actions were upheld. In the FCC radio cases, for example, the court does not appear to regard a return to reliance on market forces as anything except one regulatory option, to be weighed against the more conventional possibilities of command-and-control. One of the reasons for the FCC's success in defending its deregulatory efforts has probably been its care in explaining the importance and likely impact of market forces. By way of contrast, in repealing its smoking rule the CAB seems to have been a bit cavalier in assuming that the "market will provide." The point may have been clear to the CAB economists, but it was not so obvious to the D.C. circuit judges.

The intellectual roots of the idea of a right to regulation are too complex to trace here. They involve the history of the Administrative Procedure Act of 1946, the nature of congressional delegations empowering agencies to make rules, developments in the concept of standing to sue, the anomalies surrounding judicial review of policy decisions, and other legal esoterica. For present purposes, it is enough to note that if such a doctrine ever establishes itself, especially if it includes the idea that benefits conferred by regulation become vested rights entitled to a presumption of continuance, it could make repeal of rules very difficult. In some cases it would require the agency to show that the beneficiaries of regulatory distributions of wealth were in some way morally unworthy, which is virtually impossible. In others, it might require the agency to demonstrate clearly that the default drive outcomes would be superior. That would put deregulators in a difficult bind, since one of the most important arguments in favor of private decision processes—especially the market—is that it is hard for the government to determine which outcomes are superior to which other outcomes. An agency can hardly lay claim to omniscience in court to defend decisions premised on its lack. A judge who does not share this skepticism of command-and-control is likely to be more impressed by the losses confronting the plaintiffs before him.

Furthermore, to the extent that a right to regulation creates a presumption in favor of the status quo, the link between the rule's original purposes and the repeal proceeding is likely to be cut. If the agency argues that the premises of the rule were flawed and the rule in fact unnecessary, the plaintiff will respond that the rule had serendipitous side effects, and that it is arbitrary for the agency to limit its focus to the original rationales. (This argument was in fact offered in one of the FCC cases, but the court rejected it on the grounds that the plaintiff's interests were adequately protected through other agency regulations.)

But if this link is cut, then it becomes unclear just what the agency must establish. Must it show only that there is some plausible set of circumstances under which repeal would make sense, ignoring alternative proregulation scenarios? Must it refute every argument in favor of the rule that the beneficiaries raise? Who has the burden of proving what, with what evidence? All of these questions become imponderable.

THE STATE FARM DECISION, expected to appear before this article reaches the newsstands, will provide the general framework within which these questions will be addressed in the future. However, given the special circumstances and idiosyncratic history of the passive restraints issue, it is unlikely that the case will provide any definitive answers. In the long term, the problems of repealing rules cannot be separated from the broader question whether rules made by federal agencies do in fact create new categories of vested interests that have a presumptive right to the continuation of regulation. If they do, if the courts rule that this is indeed what Congress intended, then reverse gear on the regulatory machine may not be just hard to find; it may be virtually nonexistent. ■

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Federalism in the Supreme Court

The Fall of the House of Usery

Grover Rees III

FEDERALISM—THE IDEA THAT our central government's powers are delegated to it by the states and are therefore limited—is a rare and delicate flower that blooms briefly in election years. Even as Americans have become accustomed to having more and more decisions about their lives made by an organization known to its admirers as "the public sector," they have also come to expect that virtually all of the really important decisions will be taken at the organization's home office in Washington, D.C. The notion that the fifty states are "sovereign," that real and inalienable powers reside in deliberative bodies that meet in Topeka, Honolulu, and Little Rock, seems increasingly quaint. And perhaps worse than quaint, since it raises the specter of Balkanization of the national economy. The ritual invocation of that specter has long been used to frighten young constitutional scholars around campfires —even though, in view of the effects of the postwar de-Balkanization of the Balkan states, it does not seem unreasonable to fear other things more than having a central government that is too weak.

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Many Americans, even those who are aware that there is now in progress a struggle for the soul of the U.S. Supreme Court, would be surprised to learn that the struggle is mostly about federalism. The Supreme Court, in fact, has always taken the position that the states are true sovereigns, in the sense that there are some decisions of state legislatures that Congress cannot overrule, no matter how much it wants to. One reason the Court has taken this position is that the Constitution clearly requires it: the Tenth Amendment states that "all powers not delegated to the United States by the Constitution . . . are reserved to the States." That amendment was proposed by the First Congress as part of the Bill of Rights. It was designed to address the principal objection of those who had opposed the Constitution and an important misgiving of many who had supported it: that the federal government, once established, might eventually exercise all power to the exclusion of the states.

As Justice Sandra O'Connor has recently observed, those who ratified the Constitution had several reasons for wishing to ensure that the states would continue to hold ultimate power on all matters other than those delegated to

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the federal government. First, the recent unpleasantness with England had made them suspicious of all central governments, and they regarded diffusion of power as a way to protect individual freedom.[1] A closely related concern was that "federalism enhances the opportunity of all citizens to participate in representative government." O'Connor quoted Tocqueville's observation that the "republican spirit," the "manners and customs of a free people" are "engendered and nurtured in the different states" so that they can be "afterwards applied to the country at large." Finally, whether or not the framers of the Constitution foresaw it, state governments have "served as laboratories for the development of new social, economic and political ideas," and the nation has learned from the successes and failures of these experiments.

The justice's paean to federalism, unfortunately, was written in dissent (in *FERC* v. *Mississippi*, 1982). While the majority of the Court has always given notional assent to the Tenth Amendment's declaration that some powers are reserved to the states, it has sometimes been hard to identify any *particular* powers that the Court would place in the reserved category. For the last forty years or so, the concept of federalism has been more in evidence at the confirmation hearings of Supreme Court justices than in their decisions from the bench.

The Tenth Amendment Rediscovered

In 1976, consequently, most professional Court-watchers were startled (and many were offended) when the Court seemed rather abruptly to have rediscovered the Tenth Amendment as a rule of law. The holding in *National League of Cities* v. *Usery* was that Congress has no constitutional power to prescribe minimum wages and maximum hours for state employees. The Court reaffirmed its prior decisions that federal power over interstate commerce includes the power to regulate wages and hours for workers in private industry. But it went on to hold, for the first time in recent memory, that the federal commerce power was limited by the reserved powers of the states—in this case the right of a state government to structure its own internal operations. Justice William Rehnquist wrote the Court's opinion, and it was after *Usery* that commentators began to speak ominously of the emergence of a Rehnquist Court.

A Supreme Court decision of the recent term, however, suggests that reports of the fall of absolute federal power after *Usery* (and the rise of a majority bloc of justices committed to a "new federalism") were somewhat premature. In *Equal Employment Opportunity Commission* v. *Wyoming*, decided March 2, the Court held that the federal government has the power to prohibit the Wyoming Game and Fish Department from firing Warden Bill Crump merely because he has reached the statutory retirement age of fifty-five. In so holding, a new majority on the Court, consisting of the four dissenters in *Usery* plus Justice Harry Blackmun, has eviscerated *Usery*—without, however, formally overruling it. Before 1976 it was thought there might not be any limits on the federal commerce power; now the Court seems to be saying that such limits exist but are impossible to find.

EEOC v. Wyoming suggests that reports of the fall of absolute federal power after Usery (and the rise of a majority bloc of justices committed to a "new federalism") were somewhat premature.

Rehnquist's opinion for the Court in *Usery* has been the favorite exhibit of critics who accuse him of being a "judicial activist" who strikes down laws he finds ideologically unappealing. Indeed, such an accusation was clearly implicit in the dissenting opinion of Justice William Brennan, who expressed shock that "my

[1] Modern scholars have adduced other arguments for federalism as well. As Professor Lino Graglia has observed: "It can be shown arithmetically that if an issue is decided by larger units, involving more people, the likelihood increases that fewer people will obtain their preference and more will be disappointed. . . . As the power source is farther removed from the individuals affected, what might be called dissonance or interference in transmission—in communication and responsiveness—increases. . . . It is true, of course, . . . that the smaller unit, too, can tyrannize. . . . But at least fewer people will be tyrannized, and as long as we retain . . . a nationally enforced rule of free intra-state and inter-state movement . . . these people can leave." Thus, while local government probably does tend to be less threatening to freedom than central government, it is even clearer that the best protection of all is to prevent *any* government from monopolizing power.

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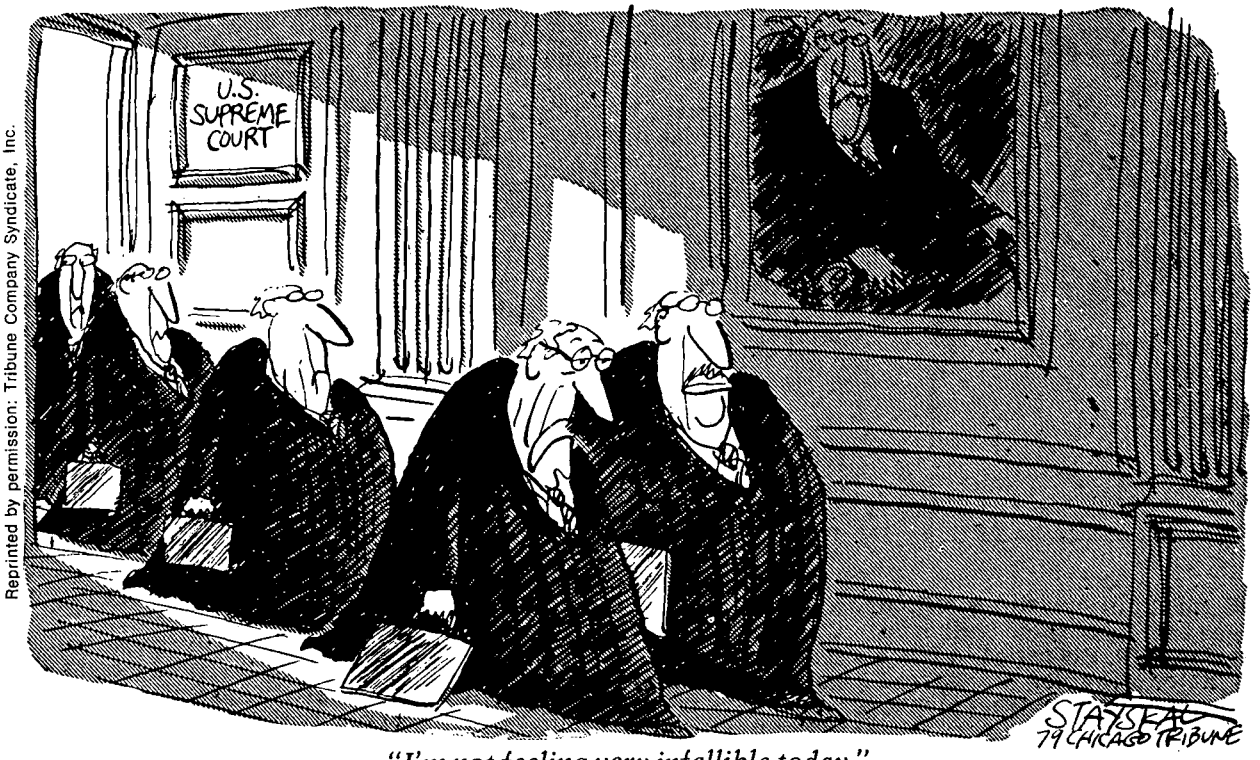
Brethren should choose this Bicentennial year of our independence to repudiate principles governing judicial interpretation of our Constitution settled since the time of Chief Justice John Marshall." The majority's decision that state sovereignty limits the federal power to regulate interstate commerce, said Brennan, was a "patent usurpation" of the power of Congress; inherent state sovereignty is an "abstraction without substance," mentioned nowhere in the Constitution and rejected by an unbroken line of judicial precedents. Quoting one of these precedents, Brennan insisted that the Tenth Amendment imposes no limits at all on federal power; rather, "the amendment states but a truism that all is retained which has not been surrendered."

One essential quality of a truism, however, is truth. The *Usery* dissent was surely right in observing that the Tenth Amendment's statement that "powers not delegated to the United States by the Constitution . . . are reserved to the States" does not help to determine how much power is delegated and how much is reserved. The majority, however, was just as surely right in regarding the Tenth Amendment as evidence that the Constitution must reserve *some* powers to the states. Any construction of the interstate commerce clause that would seem to delegate *all* power to Congress must therefore be erroneous. If an unbroken chain of Supreme Court decisions really stands for a clearly erroneous construction of the Constitution, it is the duty of the Court—as Brennan has been quick to recognize in other contexts—to break the chain.

The constitutional tradition from which *Usery* departed combined an extremely broad "structural" interpretation of the federal government's delegated powers with a "strict constructionist" approach toward the reservation of powers to the states. Only *after* drawing every conceivable inference and resolving every doubt in favor of a challenged exercise of federal power would the Court turn to the Tenth Amendment; at that point, of course, it would be too late in the analysis for the reservation to the states of "all powers not delegated" to have any effect on the case, since a delegation would already have been inferred.

The guiding principle of *Usery*, on the other hand, was that the standards for interpretation of state and federal powers should be symmetrical: limits on federal power would henceforth be inferred from the reservation of power to the states, just as limits on state power had



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"I'm not feeling very infallible today."

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long been found to be implied by constitutional grants of power to the federal government. As the dissent in *Usery* pointed out, this idea was inconsistent with many of the Court's decisions on the scope of federal power under the commerce clause; but it was almost certainly the idea behind the Tenth Amendment. Thus the dissenters' chief indictment of the *Usery* Court's constitutional vision of American federalism was that the vision was 200 years old.

Court Precedents

The view of state sovereignty espoused by the majority in *Usery*, moreover, had more support in the Court's earlier jurisprudence than the dissenters were willing to concede. Most of the decisions cited by Brennan, in fact, involved federal regulation of individuals and business associations, not federal regulation of the states themselves. When Congress uses its interstate commerce power to regulate private conduct, it thereby preempts any conflicting state laws. As the complexity of economic life in the United States has increased, the constitutional grant of power to Congress to do everything "necessary and proper" to regulate interstate commerce has been construed to encompass many activities that were traditionally regulated only by state and local governments. Despite intermittent attempts to define the boundaries of a state "police power" that can never be preempted by the federal government, the Supreme Court has more or less come around to the view that it cannot be done. Congress can regulate private activities and enterprises not only when they are "in" interstate commerce, but also when they "affect" interstate commerce or use "instrumentalities of commerce." Since everything is linked to everything else in the economy, and since everyone uses at least the "instrumentality of commerce" known as the telephone, it follows that the Tenth Amendment must reserve to the states something *other* than a state "police power" over certain types of private conduct. Unwilling to demote the amendment from a truism into an illusion, the *Usery* majority drew the line at federal regulation of the essential functions of the state governments themselves.

This distinction between laws that govern individuals and those that govern other governments was not without illustrious precedents. Indeed, the decision that gave life to the idea that constitutional grants of power to Congress should be broadly construed—Chief Justice Marshall's opinion in *McCulloch* v. *Maryland*—also spawned a line of cases holding that sovereignty implies a measure of immunity from the power of other sovereigns. Although the Constitution nowhere explicitly prohibits the states from taxing the activities of the federal government within their respective borders, Marshall held that Maryland could not tax the notes issued by the Baltimore branch of the Bank of the United States. Since "the power to tax involves a power to destroy," Maryland could exercise this power (and its other powers, including the power to regulate) only over that which "exists by its own authority, or is introduced by its permission."

Marshall based his argument for an implied limitation on state power not only on the independent sovereignty of the federal government but also on its supremacy; he attempted to distinguish federal taxation of state banks from the converse on the ground that the states were represented in Congress and could look after their own interests. But the Court soon rejected this distinction, holding that "the State is as sovereign and independent as the general government" and thus could not be taxed. For a while, during the late nineteenth and early twentieth centuries, the scope of the intergovernmental tax immunity doctrine was construed so broadly that it was held unconstitutional for the federal government to assess income taxes against the salaries of state employees. By 1946, however, the doctrine had evolved to a point where the Court, in *New York* v. *United States*, held that the federal government could tax some state-owned enterprises, such as New York's mineral water business. Certain other objects and activities, however—such as the state capitol building, public schools and parks, and the state's revenue receipts—were held to "partake of uniqueness from the point of view of intergovernmental relations," so that a federal power to tax them would "interfere unduly with the State's performance of its sovereign functions of government."

Nor did this state immunity extend only to federal *taxation* of sovereign functions; it extended to some federal *regulation* as well. In *Coyle* v. *Smith*, for instance, the Court declared

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unconstitutional a condition on Oklahoma's admission to the Union requiring that the state capital be located until 1913 at a place called Guthrie. The power to move the seat of government to Oklahoma City and the power to appropriate state funds for that purpose were held to be "essentially and peculiarly state powers." Not even in the course of exercising its otherwise "plenary" constitutional power to grant or deny applications for statehood could Congress regulate the "functions essential to separate and independent existence" of a state.

Coyle and the tax immunity cases also cited the 1868 case of *Lane County* v. *Oregon*, where the Court said that states had the right to insist on the payment of state taxes in gold and silver notwithstanding a federal statute decreeing that paper money should be legal tender for the payment of all debts. Although neither the law nor any particular provision of the Constitution expressly contained such an exemption, the Court observed that "in many articles of the Constitution the necessary existence of the states and, within their proper spheres, the independent authority of the States, is distinctly recognized." The power to tax is "indispensable" to the very "existence" of the states, and there is "nothing in the Constitution which contemplates or authorizes any direct abridgement of this power by national legislation"—even the seemingly minor abridgement at issue in the Oregon case.

The idea that federal power stops when it reaches a state government's essential attributes of sovereignty can be applied to the commerce power just as easily as to the powers of taxation, regulation of money, and admission of new states. No less than the power to tax, the power to regulate involves a power to destroy. Nor is the scope of the commerce power any more "plenary" than that of any other federal power; indeed, the Court has sometimes treated the taxing power with even more deference than the commerce power. This is partly because the language of the Constitution lends itself more easily to a restrictive definition of the latter than of the former: a regulation of state government operations is arguably not a regulation of commerce at all, whereas a tax on state governments is clearly a tax.

The idea that federal power stops when it reaches a state government's essential attributes of sovereignty can be applied to the commerce power just as easily as to the [power] of taxation.... No less than the power to tax, the power to regulate involves a power to destroy.

More Recent Cases

Not until 1968, when it handed down *Maryland* v. *Wirtz*, did the Court decide to allow federal regulation in a case involving essential attributes of state sovereignty. Over a strong dissent by Justice William Douglas, who pointed out the illogic of treating the commerce power differently from the taxing power, the Court upheld the application of federal minimum wage legislation to certain state employees. Despite the Court's reassurance in *Wirtz* that it reserved the right to prevent the actual *destruction* of a state government, the opinion effectively held the federal commerce power over state government operations to be unlimited.

Stripped to its essentials, the *Usery* majority's alleged disruption of the Bicentennial consisted in overruling *Wirtz*. Yet *Usery* was not the first case in which the Court called the *Wirtz* doctrine into question. In *Fry* v. *United States*, decided in 1975, the Court said that the Economic Stabilization Act, which decreed a "temporary emergency" during which employers would not raise employee wages by more than 7 percent, could be applied to state employee salaries. Justice Thurgood Marshall's opinion for the Court implied, however, that federal commerce power over the states might not be as broad as the corresponding power over private conduct. Marshall's opinion quoted the truism that the Tenth Amendment is a truism, but responded that the amendment "is not without significance," since it "expressly declares the constitutional policy that Congress may not exercise power in a fashion that impairs the States' integrity or their ability to function effectively in a federal system." Although the *Fry* majority held that the wage ceiling passed this Tenth Amendment test, that a test was applied at all was a departure from the *Wirtz* doctrine of absolute federal power in commerce cases.

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Rehnquist dissented in *Fry*. Although he agreed with the majority that the wage controls did not threaten the imminent destruction of the state governments, he argued that federal power to determine the salaries of state employees necessarily included the power to make decisions that would impair the effective functioning of the states. It was the very *assertion* of such a federal power, and not the empirically observable effects of its use in any particular case, that Rehnquist believed to be an unconstitutional impairment of the integrity of the states. Echoing *McCulloch*, Rehnquist contended that legal immunity from the power to destroy—and not just the happy circumstance that destruction has not so far occurred—is the test of sovereignty. Although "it is not the Tenth Amendment by its terms that prohibits congressional action" impairing any particular aspect of state sovereignty, the amendment and other constitutional provisions recognizing state integrity must be regarded as conclusive *evidence* that those who drafted and ratified the Constitution had an "understanding" that Congress "was not free to deal with a State as if it were just another individual or business enterprise subject to regulation." Rehnquist's dissent in *Fry*—or, more precisely, his dissenting application of the doctrine of state sovereignty announced in Marshall's majority opinion—was the analytic basis for the Court's opinion the following year in *Usery*.[2]

It is in the nature of landmark opinions to raise more questions than they answer. Rehnquist's opinion in *Usery* found that the federal minimum wage for state employees operated directly on "functions essential to separate and independent existence" of the states and also that the law had a "significant impact on the functioning" of the state governments. It was unclear whether one of these findings standing alone would have been sufficient to invalidate the law. Even Marshall's majority opinion in *Fry* had suggested that a law would be unconstitutional if it impaired *either* a state's "integrity" *or* its "ability" to "function." This disjunction was consistent with the Court's earlier statements on the federal tax power, to the effect that a tax would be unconstitutional if it either applied directly to the state capitol building or threatened to put the state government out of business. Yet the *Usery* Court's refusal to disapprove the actual result in *Fry*—which was to permit the application of wage and price controls to states—suggested that some federal regulation of essential state functions was still permissible. The Court distinguished *Fry* from *Usery* on several grounds, among them that the federal wage ceiling had tended not to impoverish the states but to enrich them, and also that the ceiling had been enacted pursuant to a "temporary emergency." Blackmun's concurring opinion in *Usery* added to the uncertainty by characterizing the majority opinion as a "balancing approach" that would not threaten really important federal laws, such as those protecting the environment. Under this approach even a strong state interest might be overwhelmed by a slightly stronger federal one. Although Blackmun might have been the only person who read the opinion that way, his status as an essential member of the five-vote majority made his views important.

Had the Court pursued the logic of Rehnquist's opinion, it would eventually have limited the federal commerce power to the same extent that earlier opinions had limited the taxing power. That would probably have meant disallowing any "emergency" exceptions to state immunity from federal power. If the Court had really been intent on exploring the structural implications of state sovereignty, it might someday even have rediscovered a minimal core of exclusive state authority over private conduct.

Two decisions handed down in the years after *Usery*, however, suggested that Blackmun's balancing approach was much more likely to determine the outcome of the current Court's decisions. The facts in these cases, however, were so far afield that they provided little

[2] In his *Fry* and *Usery* opinions Rehnquist employed a style of constitutional analysis for which Chief Justice John Marshall has been much admired—what Professor Charles Black has called "the method of inference from the structures and relationships created by the constitution in all its parts." Black has observed that both holdings of *McCulloch*—that the United States had the power to charter a bank and that Maryland had no power to tax that bank—were grounded not so much in exegesis of particular clauses of the Constitution as in what Marshall conceived to be "the warranted relational properties between the national government and the government of the states" implicit in the whole structure of the Constitution. In insisting that there must be some "powers not delegated to the United States by the Constitution," Rehnquist was not only refusing to call the Tenth Amendment a liar to its face; he was also redressing an imbalance created by Marshall's failure to apply to *state* powers and immunities the same structural analysis he had applied to *federal* powers and immunities in *McCulloch*.

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general guidance: one decision upheld a federal law that regulated private business enterprise and only incidentally affected a state government, and the other upheld a law enacted to deal with the "energy crisis" and thus arguably falling within a narrow exception for emergency legislation.

EEOC: Retreat from Federalism

With *EEOC* v. *Wyoming*, the Court was finally presented with a clear opportunity to reread *Usery*. The facts of the case provided no important ground for distinguishing it from *Usery*. Nor did the language of the decision offer a basis for distinguishing it from future cases to which the *Usery* doctrine might otherwise have applied. The five-justice majority in *EEOC* v. *Wyoming* included the four *Usery* dissenters and Blackmun. A concurring opinion by Justice John Paul Stevens suggested that *Usery* should be overruled, but the opinion for the Court by Brennan (whose *Usery* dissent had severely chastised the majority for claiming to distinguish *Usery* from earlier cases that it effectively overruled) asserted that *EEOC* could be distinguished from *Usery* and did not overrule it.

Brennan begins by making it clear that federal regulation of state governments can be invalidated only if it *both* regulates an essential attribute of state sovereignty and threatens to impair the state's ability to function. The latter prong of this test, moreover, means that the state must *prove* a "wide-ranging and profound threat to the structure of State governance." Since any effects of the federal retirement law on the cost of state government are "speculative," and since Wyoming remains free to retire Bill Crump if it can prove to the satisfaction of the federal judiciary that his age really disqualifies him, the state cannot carry its burden of proving that there is no way for it to structure its essential functions unless Crump retires.

In the unlikely event that a state should ever succeed in proving the requisite universal negatives, the Court would then proceed to a balancing test. A "well-defined federal interest in the legislation" could be held to "justif[y] state submission" even when state sovereignty is essentially and irremediably impaired. Well-defined federal interests will be easy to find. Brennan suggests that the federal interest in preventing age discrimination, for instance, might have been strong enough to override any state sovereignty interests, even though the federal government exempted some of its own operations from the prohibition against age discrimination: "Once Congress has asserted a federal interest, and once it has asserted the strength of that interest, we have no warrant for reading into the ebbs and flows of political decision making a conclusion that Congress was insincere." The upshot is that Brennan's dissent in *Usery*, characterizing the implied limitation of federal power by state sovereignty as an "abstraction without substance," has proven to be prophetic. The Tenth Amendment has indeed been restored to its former status as a bit of Fourth of July rhetoric posing no real obstacle to central government ambitions.

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All new federal regulations of commerce can presumably be distinguished on their facts from *Usery* just as easily as the facts of *EEOC* v. *Wyoming*. One interesting question left unanswered by *EEOC* v. *Wyoming*, in fact, is what the Court would do if Congress were to reenact the very statute that was struck down in *Usery*. Another is whether the rise and fall of *Usery* will force a reexamination of Tenth Amendment limitations on other federal powers. No bills have been offered in the current session of Congress to tax state capitol buildings or to move them closer to Washington in order to facilitate federal inspection. Pending a change in the membership of the Court or in the philosophy of one or more justices, however, the constitutionality of any such legislation will presumably depend on Justice Blackmun's relative assessment of the competing state and federal interests.

Until future Court decisions resolve this uncertainty, sovereign states are advised to obey the fifty-five-mile speed limit and to observe all other applicable federal regulations. It is best not to provoke those who possess the power to destroy. ■

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A Review Essay

On the Neoliberal Frontier

William Kristol

WRITING A YEAR AGO on the subject of neoliberalism, Morton Kondracke noted, perhaps a bit ruefully, that "the closest thing there is to a neoliberal manifesto" was *The Road from Here* by Paul Tsongas. Senator Tsongas's work must now yield pride of place to Robert Reich's new book, *The Next American Frontier* (Times Books, 1983, 324 pages, $16.60).

Reich, a lecturer at the Kennedy School of Government at Harvard, does not claim to provide a comprehensive agenda for the 1980s. Rather, he is primarily concerned with the topic of economic growth. But his economic prescriptions involve (as Reich emphasizes) broad-gauged social and political prescriptions as well. The reception given this book—laudatory prepublication statements by no fewer than four Democratic presidential contenders—may help lay to rest Kondracke's concern that "neoliberalism may lack a future." The question is whether we want the neoliberal future to be America's.

The Next American Frontier argues that the type of American industrial organization dominant for most of this century is no longer viable—and neither are the social and political structures it has spawned. The form of organization is the familiar modern industrial corporation, designed to turn out relatively simple, standardized products in large quantities, using long production lines demanding the repeated performance of routine tasks. This system is failing because other countries have learned to imitate it at lower cost and now can undersell our mass-produced goods on world markets. "The same factor that previously brought prosperity—the way the nation organizes itself for production—now threatens decline." We ought to face up to this fact and alter our underlying mode of production. But instead we have tried various "ploys" ranging from "paper entrepreneurialism" to protectionism, which at best divert us from the task of reversing our economic decline, and at worst accelerate the process.

Fortunately the Japanese and Europeans have already scouted the territory on the other side of the new frontier. The new world is a world of "flexible-system" production "based not on huge volume and standardization, but on producing relatively smaller batches of more specialized, higher-value products—goods that are precision-engineered, that are custom-tailored to serve individual markets, or that embody rapidly evolving technologies." The United States can have a comparative advantage in the production of such goods, but only if it leaves behind the premises of the old mass-production system and takes on the characteristics of the flexible system.

Reich's main concern is not to describe the mechanics of either the old or the new system of production, but rather to explicate what might be called their intellectual and sociological underpinnings. He explains that the mass-production system brought with it the "era of management," during which management grew as a profession and the "managerial imagination" came increasingly to dominate politics and society as a whole. Improvement in economic efficiency was viewed as the engine for improving the quality of life; social policies were peripheral, the "means of tidying up industrialization—responding to its unfortunate side effects, rendering it slightly more humane."

By contrast, the crucial characteristic of the new system of flexible production is that it depends on "human capital," on skilled employees' working closely together and exercising initiative, responsibility, and discretion to a far greater degree than in mass production. This requires a "new organization of work" that is "more collaborative, participatory, and egalitarian." And the new organization of work in turn

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rests on a "new organization of society," in which social policies are designed to help develop human capital as "an integral part of industrial development."

The lack of real integration between economic and social policies may have been tolerable under mass production, Reich says, but it is no longer. In fields as diverse as education, day care, unemployment, and welfare, social policies must be reevaluated on a sort of economic ground: how well they help "an entire labor force enhance its productive capacities," how well they ease and foster economic change. "In short, rather than two separate systems that interact only incidentally—one geared to production and the other to passive dependency—we will have one system, serving both economic and human development."

Reich's argument is impressive for its breadth of analysis and clarity of presentation, but it does suffer from a certain lack of concreteness. He is entitled to the disclaimer that "we can only speculate on the exact shape" of future institutions. But when he announces that "if American prosperity is to be truly restored, a substantial fraction of capital and labor must shift toward flexible-system production," it would be nice to know how big a fraction he has in mind. The book is replete with figures and statistics, but on this central question we are given very little quantitative guidance. Nor are we given detailed case studies of the two modes of production, or detailed comparisons of our "dead-end" social policies and a few of the successful social policies Reich claims to find in Japan and Western Europe. The skeptical reader may therefore fail to be convinced that "collaboration and collective adaptation are coming to be more important to an industrialized nation's well-being than are personal daring and ambition." Indeed, many of the features of flexible-system production would seem to be as consistent with individualistic and, for that matter, inegalitarian social policies as with collective and egalitarian ones.

Politics without Ideology

Reich might seem to allow for this possibility, for he says repeatedly that our choice is "fundamentally a political one." In fact, he argues that part of our problem is our failure to acknowledge the need to make such a political choice. We either shun "the uncomfortable process of political choice" entirely, or we try to disguise political choices as economic or technical ones. These efforts to submerge politics "serve only to pervert it," and the resulting choices lack coherence and legitimacy. Reich presents himself as an enthusiast for the "messy process of political debate and choice," and advocates "a more open, more public debate about economic change, in which bargains can be struck 'wholesale' in place of the covert 'retailing' that now dominates" our politics and "stymies economic and social progress."

Yet, Reich cautions, this overt political debate ought not to be of the old-fashioned ideological sort. That would sidetrack us into "endless debate over the relative merits of two highly artificial concepts: the 'free market' and 'national planning.'" These obsolete caricatures persist in dominating debate, Reich thinks, in part because of the historical split in American life between the "civic culture," which is concerned with social justice, prefers the public sphere, and disdains the profit motive, and the "business culture," which is concerned with prosperity, believes in private enterprise, and distrusts government intervention. The false choice "between these two sets of central values —social justice or prosperity; government or free market; community or freedom"—has made it difficult to discuss political issues intelligently. Above all it has separated social from economic issues, and thereby kept us from understanding "the central importance of human capital to America's future." How best to develop human capital and adjust to the changing economic realities should be the subject of a revitalized political debate. This debate is allowed to be messy—but not ideological.

Is this likely? If Americans come to agree with Reich that "public and private spheres are becoming indistinguishable," and engage cheerfully in "wholesale" debate about how to restructure the society and economy, how likely are they to shun ideology? In deploring the "divisive struggle between business culture and civic culture" that has marked American politics, Reich claims that other industrial nations, such as Germany under Bismarck, have "avoided this ideological trap." But does Germany really furnish a good example of how a nation avoided the blight of ideology? And is it unrea-

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sonable to suggest that America has escaped many of the ravages of ideology precisely because it has divided public from private spheres (even at the cost of creating two "cultures"), and because it has shown a preference for taking its politics "retail" instead of wholesale? The disjunction of public and private may be somewhat artificial intellectually; it may make policy making difficult; and it may never have been fully lived up to in our practice. But the dangers of throwing everything open to wholesale political choice suggest that, if anything, our practice ought to be brought more closely into line with our ideology, that the separation of public and private spheres ought to be strengthened rather than obliterated.

Reich does not seriously consider this possibility because he assumes that the explicit and wholesale political debate he wants would not be divisive; at times he even seems confident that it would produce a "consensus for progress" and a "commitment to active adjustment." Underlying this confidence is the fact that his political debate would not be a debate between competing political visions. It would not pose "the false choice between civic values and business values," or really between any values. The choice it would pose is between adapting and failing to adapt, between prospering and going into decline. With these as alternatives, it is easy to see why Reich says "the political choice is clear."

But surely this is to trivialize the meaning of "political choice." Reich's oft-repeated enthusiasm for the process of political choice lets him distinguish himself from the "managerial imagination" and its "myth of an efficient and apolitical society." But in fact Reich's prescription seems to be only a disguised form of managerialism—managerialism with an overlay of political debate, managerialism with a human face.

Adaptation or Choice?

Reich's managerialism is also an updated form of managerialism—what we might call "historical managerialism." For the reason that there is no real need for us to choose among political ends is that history has mandated our choice—or, which is the same thing, freed us from having to choose. Choice for Reich consists of "active adjustment" to the new realities. Thus "adaptation is America's challenge. It is America's next frontier." The old frontier was conquered in the name of Manifest Destiny; the new frontier is to be adjusted to in the name of Adaptation.

Of course, just as the appeal to Manifest Destiny was in fact an appeal to a particular vision of American destiny, so the appeal to Adaptation is an appeal to a particular understanding of what the American future should be. History allows Reich to avoid confronting other understandings on their merits: "the ideology of wealth and poverty" may well have been "a fitting ideology" for an earlier era, he says, and the era of management may have been "essential to the next stage of America's economic growth and social progress," but now they are outdated. History, or the need for adaptation, requires that we now foster especially the qualities of collaboration, cooperation, group commitment, participation, and greater equality. But is this not simply Reich's own view—a perfectly respectable view—of what human qualities are most admirable, of how society ought to be organized? If behind Reich's enthusiasm for political debate is a disguised managerialism, then behind his historical managerialism is a doubly disguised—but undefended—political choice.

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Perhaps Reich's view is the correct one. Perhaps America ought to embark on "a more general change of customs, attitudes, and values which are parts of our cultural heritage." But a general change of that sort cannot be defended on the grounds that adaptation to "new realities" is needed. Embarking on such a change, or on a different course, is fundamentally—within certain limits, of course, but fundamentally—a matter for reflection and choice. Acknowledgment of this fact would make possible the intelligent political debate for which Reich hopes. ■

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Readings
of particular interest

"Runaway Bureaucracy" Revisited

"The Federal Trade Commission and Congressional Oversight of Antitrust Enforcement" by William E. Kovacic, in *Tulsa Law Journal*, vol. 17, no. 4 (1982), pp. 587-671.

The Federal Trade Commission of the 1970s is often asserted to be the classic example of a "runaway bureaucracy" operating without congressional control. In a 1979 floor debate, for example, Representative William Frenzel (Republican, Minnesota) said "the FTC's excessive nose-thumbing at the legislative branch has become legend" and pronounced the commission a "rogue agency gone insane."

This rogue-agency thesis has come under criticism recently (see Barry R. Weingast and Mark J. Moran, "The Myth of Runaway Bureaucracy—the Case of the FTC," *Regulation*, May/June 1982). In this study, William Kovacic, an attorney with the FTC, assesses the validity of the thesis as it applies to the commission's antitrust enforcement policies from 1969 to 1980. Kovacic rejects the view that the FTC's activism on antitrust matters contradicted congressional policy guidance. In fact, he finds that for most of the 1970s Congress "used virtually every tool at its disposal" to propel the FTC toward the far-reaching antitrust initiatives it later complained of.

Kovacic begins by reviewing the 1969 report of an American Bar Association commission set up to study the FTC, which he says strongly influenced Congress's later behavior. The ABA panel, though highly critical of what it considered the agency's plodding style of antitrust enforcement, recommended that the FTC keep its legal authority in the area and went on to suggest that it concentrate on economically complex matters in unsettled areas of the law, limit its enforcement activities to cases involving substantial commercial stakes, and rely more on binding, compulsory remedies. Noting the apparent failure of many earlier efforts to reform the agency, the ABA panel said that Congress and the executive branch would have to cooperate if the new antitrust initiatives were to succeed. Kovacic says these external forces along with other forces such as public opinion and the judiciary have historically not encouraged the commission to pursue a strong antitrust policy—but that the situation in 1969 was an exception.

The ABA report catalyzed powerful reform-minded forces within Congress. In the second half of his study, the author describes how these forces pushed the commission toward the frontiers of antitrust enforcement in the 1970s. The oversight and appropriations committees demanded boldness and experimentation in FTC antitrust enforcement, suggesting that the continuation of the commission's competition authority "depended upon its development of ambitious, aggressive enforcement programs." Gale McGee (Democrat, Wyoming), chairman of the Senate Appropriations Subcommittee, conveyed what Kovacic says was the prevailing congressional view in 1971 when he told FTC Chairman Miles Kirkpatrick that "we would rather you make a mistake innovating, trying something new, rather than playing so cautiously that you never make a mistake." Similarly, in 1973, Senator Ted Stevens (Republican, Alaska) informed FTC Chairman-designate Lewis Engman that he hoped Engman would become "a real zealot" in using the commission's powers.

Beyond articulating its preferred enforcement philosophy, Congress singled out such sectors as energy, food, health care, and transportation for special scrutiny and pressed the commission to emphasize structural or industry-wide enforcement strategies. It also added several important substantive, remedial, and data-gathering powers to the FTC's arsenal and passed twelve statutes enlarging the agency's role in advocating competition before Congress

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and at federal agency proceedings. Appropriations for FTC competition activities rose from about $7.8 million in fiscal 1969 to roughly $32 million in 1980.

By the mid-1970s, many committees and congressional leaders were applauding the FTC's antitrust activism. According to Kovacic, this congressional enthusiasm crested in 1976, after which election defeats and retirements began to deplete the ranks of congressmen who had supported activist policies, including many committee and subcommittee chairmen. Just as programs started in the early and mid-1970s were coming to fruition, the FTC found itself required "to justify its competition projects before a Congress that had significantly less stake in defending or maintaining FTC work begun through 1976 and possessed a stronger inclination to review new proposals more critically."

"To depict the 1970s as a time in which Congress functioned as an inattentive, ineffective overseer, leaving the FTC to account only to itself, stands the situation on its head," Kovacic says. When Congress attributes ambitious FTC enforcement in the late 1970s to "runaway" bureaucracy, he adds, it avoids candidly confronting the shortcomings of the policy guidance it supplied so assertively up to 1976.

OSHA and Job Risks: Revealed-Preference Theory at Work

Risk by Choice by W. Kip Viscusi (Harvard University Press, 1983), 200 pp.

According to W. Kip Viscusi, director of the Center for Study of Business Regulation at Duke University, ninety-six major regulations proposed by federal agencies between 1975 and 1980 had a combined cost in present-value terms of between $300 billion and $850 billion. The most costly regulations were those proposed by the Occupational Safety and Health Administration and the Environmental Protection Agency. The costs OSHA sought to impose ranged from $100 million to $500 million, with the wide range of uncertainty due mostly to the unknown consequences of the agency's carcinogen policy. EPA's planned impositions totaled between $200 billion and $300 billion.

In this book Viscusi synthesizes his academic work on risk regulation, presents new empirical evidence on OSHA's effects, and examines the efficiency of various sorts of workplace safety regulation. He concludes that OSHA might have succeeded in promoting better worker health at lower cost had it pursued a more balanced approach.

In the House and Senate debates before OSHA was created in 1970, the Bureau of Labor Statistics injury frequency rate for manufacturing industries was repeatedly cited to prove that job injuries were on the rise. Viscusi says that the increase was a "statistical artifact" because the mix of injuries included in the BLS figures changed from year to year. Moreover, he observes, the BLS series was the only one of the published data series on job risks to show an increase over the period. All other series showed job risks declining in a trend that has continued throughout the century.

Since OSHA was established, job risks have declined at the same rate as before, according to the major econometric studies on the subject, Viscusi says—which suggests that the agency has had little if any success in its mission. This is not surprising, he claims: given the costliness of compliance and laxity of enforcement, one should expect firms to make little effort to comply with the regulations.

Despite the rigidity of its engineering standards, he says, OSHA's enforcement is comparatively weak. A typical firm has roughly one chance in a hundred of seeing an OSHA inspector in any given year and, if inspected, faces an average of 2.1 violations for which there is an average penalty of $193. "The risks that market forces are perhaps least equipped to handle—toxic and hazardous substances—accounted for fewer than 1 percent of OSHA violations through 1976 and even now are responsible for only 5 percent of all violations." Investigations of complaints by employees are given priority treatment but result in relatively few citations.

The author believes that OSHA should rely more in its regulation on the existing market incentives such as existing wage differentials for jobs of different riskiness. He calculates that wage premiums for risk alone add up to some $70 billion a year, which is about 3,000 times as much as business pays in OSHA penalties. His studies suggest that even workers who

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are unaware of a job's risks when they take it are apt to discover the degree of hazard on the job and then quit if the job is too hazardous to be worth it to them given the wage differential. According to the author's estimates, as much as one-third of the quit rate in manufacturing industries may arise from risk avoidance. High quit rates, like compensating wage differentials, impose costs on employers and thus encourage them to reduce hazard.

Market mechanisms do not function optimally for all classes of risk, the author says, since individuals may be unaware of the risks they face even after a long time at a job. This may be of particular importance in the case of dimly understood health risks. Although government regulation may be warranted when market mechanisms fail, he maintains, it should rely primarily on individual and firm choice if it is to be effective. For example, it should employ the same wage/risk trade-off in evaluating hidden risks that workers display voluntarily in responding to known risks. Researchers studying known risks have generated a considerable range of estimates of implied values per life, from $500,000 to $3 million or more, but that simply reflects the fact that risk preferences vary greatly from one group of workers to another, Viscusi says. Those who attach relatively low value to risk avoidance are likely to be attracted to high-risk jobs.

One reason individuals differ in their willingness to accept risks arises from differences in wealth. The steady decline in fatal accidents over the past fifty years has been roughly proportional to the rise in per capita income over that period, which suggests that workers have been using their new prosperity to "buy" safety. Viscusi says that proposals to restrict the export of hazardous goods, and also the import of goods that are produced under hazardous conditions, may be attempts to impose the risk attitudes of highly advanced countries on foreign workers and consumers who might incur such risks voluntarily. The "greater danger from wealth differences," he says, "is not that the poor will choose to incur risks, but that the rich will take interventionist actions."

The author outlines a number of ways that OSHA could bring some of its standards and policies, including its carcinogen policy, into line with benefit-cost principles—among them, adopting different standards for different worker groups, as was done in the cotton dust case, and permitting the use of protective personal equipment instead of engineering controls. He would also have OSHA turn from issuing standards to providing information on job risks and encouraging "merit rating" for workers' compensation premiums. It should keep legal penalties in reserve to address selected risks, primarily health risks, that the market cannot deal with effectively. One example of a well-considered regulatory initiative, he says, is the chemical labeling regulation that OSHA proposed in March 1982.

Fresh Data on Rail Deregulation

"The Impact of Rail Deregulation on the Movement of Fresh Fruit and Vegetables" by H. Wade German and Michael W. Babcock, in *The Logistics and Transportation Review*, vol. 18, no. 4 (December 1982), pp. 373-384.

During the 1960s and 1970s the railroad business grew much more slowly than the general economy. While industrial production increased 161 percent from 1955 to 1979, and trucking, oil pipeline, and inland water traffic expanded by similar magnitudes, rail traffic grew by only 47 percent. The railroads earned 56 percent of all transport revenues in 1955, compared with the truckers' 32 percent; by 1978 those shares were exactly reversed.

The decline was especially steep in the fresh fruit and vegetable market: the rail share fell from 35 percent in 1964 to 8 percent in 1979. One reason was that extensions of the interstate highway system made trucking faster and more reliable, both of which factors are crucial in the highly volatile business of transporting perishables. But regulation was another major reason for the railroads' losses, according to H. Wade German of Union Pacific and Michael W. Babcock of Kansas State University. They argue that the Interstate Commerce Commission's lengthy rate approval process and restrictions on service prevented the railroads from adapting quickly to changing market conditions. Truckers could raise or lower their prices at will to meet large seasonal and year-to-year variations in demand because unprocessed farm products were and are exempt from

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ICC trucking rate regulation. Until March 1979, however, railroads could not.

The Railroad Revitalization and Reform Act of 1976 substantially reduced the amount of rate and service regulation railroads faced. Among other things, it authorized the FCC to exempt certain commodities from all rate regulation. On March 21, 1979, the commission issued an order giving such an exemption to fresh fruit and vegetable traffic.

The authors constructed a model, using data from the period 1964–1978, of how rail tonnage of fresh produce is affected by the relative rates and service levels of railroads and trucking lines. They found that tonnage was highly sensitive to both rate cuts and service improvements, which indicates, they say, that railroads had good prospects of using their new freedoms to win back new business. And, in fact, that is exactly what happened. Rail rates on perishables declined relative to truck rates. Service improved in various ways, including the introduction of unit trains that reduced transit time.

These steps helped railroads regain market share remarkably quickly, German and Babcock say. For the four major western railroads, seasonally adjusted fresh fruit tonnage rose by 298 percent (Burlington Northern), 176 percent (Santa Fe), 166 percent (Union Pacific), and 40 percent (Southern Pacific) from the first quarter of 1979 to the second quarter of 1981, while fresh vegetable tonnage rose 107, 351, 34, and 81 percent, respectively.

Do Cuts in Federal Aid Strain State and Local Budgets?

Federal Grants-in-Aid to New Hampshire and Revenue Adequacy by Colin D. Campbell, James R. Fries, and Rosemary G. Campbell (Concord, N.H.: Business and Industry Association of New Hampshire, 1982), 23 pp.

Federal financial aid to state and local government is frequently defended on the ground that it enables the lower levels of government to cut taxes. When the federal government reduces its grants, it is argued, the lower levels of government usually have to raise their own taxes to pick up the tab.

Colin D. Campbell and James R. Fries of Dartmouth College and Rosemary G. Campbell set out to test this theory by comparing trends in federal grants-in-aid to New Hampshire with trends in the tax burden that the state and its subdivisions imposed on citizens from 1970 to 1980. (They defined the tax burden as all revenues the two levels of government obtained from nonfederal sources, including revenues from the state monopoly liquor stores.) They found that, when both figures were expressed as a percentage of the personal income of the state's residents, the tax burden tended to vary directly rather than inversely with federal aid. From 1970 to 1976 taxes increased from 11.7 percent to 13.5 percent of personal income, but after that they began to decline, dropping to 12.2 percent by 1980. Federal aid rose rapidly from 2.5 percent of personal income in 1971 to 4.1 percent in 1976, but then leveled off; in 1980 federal grants amounted to 4.2 percent of New Hampshire citizens' personal incomes.

The authors note that one cannot predict how a particular cut in federal aid will affect state and local outlays without knowing how the grant program involved is financed and administered. When Washington provides matching grants, federal and local outlays may rise and fall in tandem.

In 1980 New Hampshire and its subdivisions got 39 percent of their federal funds from waste-water treatment grants, Medicaid, and highway grants. In the waste-water and highway grant programs, the federal government achieves its cutbacks by approving fewer grant applications. Since most of these projects are financed through matching grants, state and local spending probably drops along with federal spending. In other important matching-grant programs such as Medicaid and Aid to Families with Dependent Children, the federal government cuts its outlays by tightening eligibility requirements so that fewer persons qualify for benefits. These cuts, too, reduce state and local spending.

Some aid programs are fully funded by Washington, as are employment and training (CETA) assistance and community development block grants. States and localities might respond to cuts in these programs by raising their own spending, since the programs are backed by established constituencies. But quite often the governments drop the program in-

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stead, possibly because of the difficulty of raising taxes.

The authors also compare New Hampshire's finances with those of its next door neighbor, Vermont. Both the level of federal aid and the tax burden have been sharply and consistently higher there than in New Hampshire.

The drop in both states' tax burden since the mid-1970s was typical of other states as well and is an important new development that the authors say has yet to be fully recognized. Although New Hampshire has lower taxes than most other states, its tax burden had been rising for twenty years before 1976. Among the reasons for the decline in the state and local tax burden are that fewer children are attending public schools and that major highway projects have been completed. But 1976 was also the year that federal aid began to top out, which suggests that such aid had, at a minimum, not been serving to cut state and local taxes—and perhaps even that it had been serving to increase them.

No Overturned Boulder in Sight

Antitrust and Local Government: Perspectives on the Boulder *Decision*, James V. Siena, editor (Seven Locks Press, 1982), 211 pp.

Until the late 1970s it was assumed that the actions of local governments were immune from scrutiny under the antitrust laws. After all, the Supreme Court had in 1943 explicitly found state governments to be immune, and local governments are merely subdivisions of state governments. Moreover, the Court had relied in its ruling on the absence of any evidence that Congress meant for the antitrust laws to reach state actions, and there was no evidence that Congress meant for the laws to reach the actions of local governments either. In a 1982 decision, however, the Court ruled that local officials enjoyed no such general immunity. This book, edited by Washington attorney James Siena, contains a variety of viewpoints on the aftermath of that decision.

From 1975 on, the Court had been chipping away at local immunity in a series of decisions. (See "Antitrust Comes to City Hall," Joe Sims, *Regulation*, July/August 1979.) In 1978, for example, it held that municipally owned utilities were subject to antitrust challenge. This decision did not unduly alarm local officials, in part because Chief Justice Burger's opinion, which was the deciding one, emphasized that the municipal utility was a business competing with private businesses, and not many activities of local government fall into that category.

But whatever comfort local officials took in the seeming narrowness of the utility case was shattered in the *Boulder* case of 1982. The Court held, five-to-three, that the city of Boulder, Colorado, opened itself to antitrust challenge when it passed an ordinance restricting the expansion of a cable TV franchise. Rather than resolving the question whether Congress meant the antitrust laws to reach local government actions, the majority relied on an unusual distinction: it said that state governments, but not local governments, have the "attributes of sovereignty" that entitle governments to antitrust immunity. Local governments could therefore enjoy immunity, it said, only where the state had specifically sanctioned, perhaps even directed, an anticompetitive result. (Boulder had adopted the ordinance under its broad "home rule" powers rather than pursuant to explicit state direction.) In a vigorous dissent, Justice Rehnquist said the ruling might spell the end of the home rule movement by which states had devolved many of their powers to local units of government. He also predicted that courts would find it difficult to weigh local government actions in the scales of economic efficiency ordinarily used in antitrust enforcement.

Siena points out that the *Boulder* decision threw local officials into confusion, not only because they were unacquainted with the antitrust laws, but because the Court reserved many legal issues for future decision. As local plaintiffs have learned more about the *Boulder* decision they have challenged more and more longstanding practices of city councils, mayors, and franchise and licensing boards. Recently the former mayor of Houston and others were held personally liable for multimillion-dollar damages in a suit challenging the procedures the city had used when it allocated cable television franchises.

In the spring of 1982 the National League of Cities sponsored a conference on the impli-

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cations of the *Boulder* decision for local government. This book consists of twenty papers from that conference. Two are by academic experts: L. A. Sullivan of Berkeley describes the development of the state action doctrine, and Leonard Orland of the University of Connecticut describes how states can explicitly immunize their subdivisions. Ten papers are by legal practitioners, most of whom offer advice on where exposure might lie and how local governments might go about avoiding it, and eight are written by local government officials. Among the authors are lawyers who participated in the Boulder and Houston cases, and former antitrust chief John H. Shenefield.

Some contributors argue that local governments not only will manage to live with antitrust liability, but will govern better because of it. Other contributors, including former Attorney General Benjamin Civiletti, would like Congress to overturn the decision and restore local immunity—but complain that the lawmakers seem in no particular hurry to do so. Siena believes there is also a good chance that, should Congress act, it will immunize only "traditional" local governmental functions in the health, safety, and welfare areas—which means that antitrust will have become a permanent fixture at City Hall.

Regulation of Gene-Splicing: The Story So Far

"Industrial Involvement in the Development of NIH Recombinant DNA Research Guidelines and Related Federal Policies" by Joseph G. Perpich, in *Recombinant DNA Technical Bulletin*, vol. 5, no. 2 (June 1982), pp. 59-79.

When recombinant DNA technology came to the fore in the mid-1970s it brought two widely held values into collision: free scientific inquiry and protection of the environment and public health and safety. This article describes the six-year process by which the National Institutes of Health developed guidelines for recombinant DNA research. The author, Joseph G. Perpich, was associate director of NIH for program planning and evaluation at the time and is now vice-president of Genex Corporation of Rockville, Maryland.

Almost as soon as researchers discovered how to transplant genes from one life form to another, environmentalists and others began raising questions about the risks such transplants might pose to workers or, if the organisms escaped, to the public and the environment. In October 1974 NIH established a panel to develop safety guidelines for DNA research. The panel reported its recommendations in January 1976, but the NIH director did not adopt them at once, deciding instead to air the issues in an open forum of scientific and public opinion and then compile a public record to back up the eventual decisions.

The resulting guidelines, issued June 23, 1976, provided for monitoring of research but stopped short of formal regulation. The NIH's work, however, was far from done. Over the next three years, it was absorbed by three major related issues: whether the guidelines should be made mandatory (and, if so, whether they should preempt state regulation), whether the environmental impact statement on the guidelines had been adequate, and whether recombinant DNA inventions should be patentable.

- Making the NIH guidelines legally binding would logically have required legislation, because existing statutes, either alone or in combination, did not give regulators the authority to reach all DNA research. A panel originally created by the Ford administration in 1977, and whose work the Carter administration endorsed, recommended legislation to create such regulatory authority and to preempt state regulation except where the Department of Health, Education, and Welfare saw fit to grant an exemption. After debate on this and similar proposals, committees of both House and Senate endorsed bills that were more restrictive than the administration bill. But in the end Congress failed to pass legislation on the subject, in part because new scientific evidence indicated that many types of DNA research were not really so dangerous. In fact, NIH itself soon began loosening its guidelines, progressively exempting broad categories of research from coverage as the safety of DNA research was documented.
- NIH also had to fend off two lawsuits brought under the National Environmental Policy Act. The first suit, which was later dropped, claimed that it was illegal for NIH to publish

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guidelines or allow research to proceed before finishing its environmental impact statement. The second suit charged that the agency's impact statement on one of its own proposed DNA experiments was inadequate. The court upheld the agency, however, and allowed the research to proceed.

• The patent issue arose in 1976 when Stanford University and the University of California asked NIH for an advisory opinion on whether they could patent DNA inventions they had developed with the agency's financial support. Under a presidential order issued in 1963, the federal government can enter into an "institutional patent agreement" with a university or nonprofit institution waiving federal rights to inventions developed under federal grants and contracts. The Department of Justice, arguing that DNA inventions were too important to be handled under these IPA rules, wanted the federal government to keep title to all patents in the area, as it does for nuclear fission. Private parties were already allowed to patent other biological products and processes, however, and the NIH director concluded that there was no compelling reason not to extend these rights to federally supported recombinant DNA inventions as well. (The Supreme Court's *Chakrabarty* decision confirmed this line of reasoning.) Commercial projects received another boost when Congress passed the Patent and Trademark Act of 1980, which gave universities, small businesses, and nonprofit organizations the right of first refusal to ownership of items they invent under government grants and contracts.

In the past few years, as commercial applications of DNA research have developed, the industry's programs of voluntary compliance have become more sophisticated. The author believes that NIH succeeded in creating a "flexible, open system that can accommodate new scientific information" without the new legislation or new independent regulatory commission that many had called for early in the controversy. He concludes that the openness of the process by which the guidelines were developed helped ensure their survival, since oversight by Congress, the executive branch, and the public and scientific communities strengthened the reliability of NIH's decision making and ensured public acceptance of its eventual decision.

Thoughts on Broadcasting Reform

(Continued from page 20)

if not greater economic efficiency, radio frequency users should have to pay a fee at least large enough to recover the out-of-pocket costs of administering the current regulations. At present, private users of the radio spectrum—which are among the most prosperous elements of American business—do not pay even nominal filing fees. The FCC tried in the seventies—halfheartedly, some say—to impose small annual user charges sufficient to make the agency self-sustaining, but its efforts were overturned on appeal. More recently, Senator Bob Packwood (Republican, Oregon) and others on the Senate Commerce Committee have commendably called for adoption of such a fee system by statutory means.

Even this very rudimentary application of spectrum economics, however, has encountered strident opposition. Parts of the industry object to having to pay fees for what they contend taxes should cover. State and local government agencies want exemptions. Then, of course, there is the question whether the federal government itself should be charged for its occupancy of some 40 percent of the radio spectrum. Federal agency use now is regulated by the National Telecommunications and Information Administration (NTIA) of the Commerce Department, and relative to the FCC's cost of enforcing its private sector regulations, NTIA's costs are modest indeed. But if the government were to be assessed at the same rate as private users, those costs would be substantially bigger.

Not many players in the spectrum economics field, however, are content to simply fulfill the "equity principle." For some authorities—including Chairman Timothy Wirth (Democrat, Colorado) of the House subcommittee on telecommunications, at least until recently—no deregulatory scheme is acceptable unless it embodies a second principle, "equity plus." That principle would require the fee to cover not merely the costs of regulation but also some part of the economic value of the privilege conferred.

Underlying this approach to broadcast deregulation is the belief that the prevailing regime ensures a sort of payment-in-kind to the public. In return for their radio or television licenses, the argument goes, broadcasters be-

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come public trustees and are required to undertake sundry tasks that the government, if not the public, considers socially redeeming. Thus, broadcasters have to give discount rates to political candidates, air a certain number of hours of "uplifting" public-affairs shows that no one would ever sponsor, and so forth. If these regulatory impositions are to be lifted as part of an overall deregulation measure, broadcasters must, in fairness, pay more than just the administrative costs of their own regulation.

This ransom or hostage approach has a certain logic and enjoys fairly widespread appeal among all parties except TV broadcasters, who are strongly opposed. The most obvious problem it raises is how to set the fee—that is, how best to calculate the "true value" of the various public services the present regulatory regime supposedly provides. A related problem, once again, is what to charge government for its use of the spectrum.

Ideally, one would want spectrum costs to be figured into the overall cost of the government's spectrum-consuming programs. In estimating the total costs of a weapons system, for example, defense planners should be obliged to take into account not only its hardware costs, but the "price" of the spectrum needed to support it as well. Currently, they pay nothing for the radio channels they use—nor does any other part of the federal establishment, including Congress, the Supreme Court, the Postal Service, even the FCC itself. Obviously, however, federal spectrum usage costs something, and perhaps a substantial amount. Were the radio spectrum not a free good to government agencies, they might release for private exploitation part of the 40 percent of the spectrum they now use. They might also have an additional incentive to use the spectrum more efficiently, by purchasing more finely tuned equipment, for example.

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The practical problems of moving to a federal "equity plus" assessment make one wonder whether this trip is really necessary. Is the defense budget—which some find too high already—to be further ballooned? Since the receipts from any such assessment would simply flow from one agency's pocket to another's, why bother? What about the prospect that foreign countries might follow the U.S. example and begin levying charges on U.S. government use of radio frequencies abroad? Congress might be particularly loath to sanction budgetary churning in this area, given today's fiscal austerity imperatives, if the scheme also meant that our government would pay Japan for the radar and associated communications operations we support today to defend its islands. Placing "equity plus" assessments on federal spectrum users, in short, may be economically elegant. But persuading Congress to embark on a brave journey toward greater economic efficiency is another matter.

A Spectrum Market. If radio frequency users are to reimburse the government for both regulatory costs and the "public service" benefits forgone, it would seem logical to give them some kind of indefeasible property right in their frequency. As a practical matter, most licensees already enjoy a property right of sorts, the simplistic language of the 1934 Communications Act notwithstanding. Legally, a property right in its most fundamental sense is simply the ability to enlist the government's aid in furtherance of one's prerogatives. One has a property right to one's home, for example, because one can enlist the aid of the police, the courts, or other governmental agencies to keep somebody uninvited from moving in.

As a practical matter, most licensees already enjoy a property right of sorts, the simplistic language of the 1934 Communications Act notwithstanding.

In the case of radio users, the FCC license confers among other fundamental rights the power to enlist the government's help in securing the user's relatively exclusive use of the channel involved (unimpeded in the case of most services). If, for example, another firm starts broadcasting on television channel 4 in

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Washington, it is up to the government, not simply NBC, to get the trespasser to cease and desist. Most spectrum users today also enjoy yet another of the basic attributes of property, the right to pledge or alienate their holdings. Granted that the FCC's anti-trafficking rules still impose certain residual restrictions on license sales (a TV license, for example, cannot be sold separately from the station's facilities). But anyone who doubts there is a fairly active market in radio spectrum properties should check the weekly want-ads section in *Broadcasting*, the leading trade publication.

A substantial body of legal writing purports to address largely imaginary problems of adequately defining property rights to the spectrum. Suffice it to say that, despite the FCC's long-perpetuated myths about the people's airwaves, defining such rights is not really a problem, given the diversity of ownership and other entitlements schemes developed by generations of lawyers.

Although radio licensees may thus have property rights much like those one enjoys to one's home, these rights are subject to very rigid zoning codes. One may not, for example, aggregate rights to adjacent land mobile-radio channels and commerce broadcasting TV signals (even assuming that existing sets could decipher such signals). Conversely, and although not a few undoubtedly would like to do so, one may not obtain the rights to an unassigned, vacant UHF channel and break it down into land mobile-radio channels. As previously explained, under the FCC's table of allocations, one set of channels is allocated to one service, and another to another. That is why the economists go on to demand that channels be bought and sold as unencumbered, unzoned real estate, to be divided, combined, or otherwise exploited as efficiently as possible. This is not a completely fanciful notion, but it raises legal, economic, and technical problems that are even more complicated than those of the "equity plus" scheme. Not only are not all hertz technically equal, fungible, and interchangeable, but the FCC's categorical allocations generally track international allocations that are fairly well fixed by treaty. While we could legally depart from the international allocations, provided we did not cause interference to other signatories, ordinarily the United States sticks closely to the international radio frequency rules.

Two other obstacles stand in the way of moving quickly to a full market approach. The first is the size of the sunk (or embedded) costs associated with the present regulatory scheme. According to one estimate, for instance, there are now more than $70 billion worth of television receivers in some 96 million homes, a hardware investment substantially larger than the broadcasting industry's. A change in our current engineering practices and rules would potentially jeopardize the efficient performance of those sets. Similar problems exist in other radio services, although perhaps to a lesser extent. The second obstacle is the impact that changes in the rules affecting other services might have on television equipment. As those who have experienced television interference from CB radio or other sources can attest, one service can directly affect the performance of others. The FCC minimizes these problems today by making relatively few changes in existing services and following the traditional frequency management rule that the "last in" (the new services) adapt to the existing radio spectrum environment—even when, as often happens, the incumbents can adapt more cheaply than the newcomers. In any event, the existence of substantial sunk costs, major public investment, and technical service interrelationships greatly complicates any plan to move to an unregulated market.

Finally, there is the familiar question of what to do about the federal government's portion of the spectrum. Idealists may think the government should buy spectrum just as it buys paper and typewriters, but realists know that will never happen, particularly given how much spectrum it consumes. Charging private users

Idealists may think the government should buy spectrum just as it buys paper and typewriters, but realists know that will never happen....

but not the government is equally impractical, because the government's 40 percent is not concentrated in a particular portion of the spectrum but consists mostly of its share of bands that federal and private parties both use.

The theory of the second best teaches that if one has a solution to a problem—but a key in-

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gredient is unavailable—one is probably better off finding some quite different solution. In the case of the full market approach to spectrum economics, two of the necessary ingredients are to ensure (1) that we achieve far greater flexibility of spectrum use (including the ability to shift uses between allocation categories) and (2) that all users (or at least most) abide by the marketplace rules. And from the outset we know that the largest single user—government—in all probability will not play the game.

Toward Piecemeal Reform

The MacAvoy-Besen-Nelson law of deregulation holds that the more a given regulatory system departs from desirable competitive, pro-efficiency, and marketplace norms, the greater the costs of changing it and thus the harder it will be to change. Today's radio spectrum management system was designed initially to further engineering, not efficiency or competitive, goals. Given the major problems that have been encountered in simply trying to implement the "equity principle"—that most rudimentary of the spectrum economics notions—the chances of our shifting to a full-blown spectrum market in the short run are not great.

Fortunately for the dyed-in-the-wool deregulators, however, we are already implementing some variations on that scheme. Be sure not to tell anyone. But, for a long time, people have actually been selling FCC radio frequency licenses, the people's airwaves—although, for propriety's sake, the price in the pertinent sales documents is labeled "capitalized good will and other intangibles." The FCC this spring sanctioned subdividing FM radio channels in some instances in order to allow FM broadcast licensees to utilize the subcarrier portion of their signal to transmit data, to provide paging or beeper services, and the like. Merrill Lynch and public broadcasters have an experimental authorization to explore means by which the "vertical blanking interval" that is part of the television signal can be exploited for common-carrier-like offerings. Piggybacking services of these kinds are one of the objectives of those who are urging upon us a purer, and more obvious, regime of spectrum economics.

We are, in short, kind of edging up to a system of spectrum economics, and someday we may even get there. But it will not be soon. ■

CAB + ICC + FMC = NTC?
(Continued from page 11)

matter. The ICC exercises the same sort of policy judgment when it considers new applications for trucking authority.

To complicate matters, the executive branch may well wish to appear to distance itself from especially touchy or unpopular decisions. One such notable case is that of reciprocity in international traffic, where the White House currently has it both ways: the independent CAB makes the determination that foreign countries have unfairly denied reciprocal landing rights to U.S. carriers (and is thus supposed to take the heat) but the President himself has ten days in which to disapprove its retaliatory measures. Similarly, the FMC recently came close to retaliating against Venezuela's shipping lines for that country's alleged exclusion of U.S. carriers from some bilateral trade, with the executive branch reportedly exerting considerable influence behind the scenes. (The dispute was resolved through diplomatic negotiations instead.) Even on reciprocity matters, however, there is precedent for vesting power directly in the executive branch: the Interior Department passes judgment on foreign reciprocity in granting mining rights on public lands.

Reformers might have more clout on these structural matters if they all agreed on one view. Instead, one school of thought holds that structural reform is, if not irrelevant to the substance of agency decision making, at least a tremendous diversion from the task of substantive reform. Those who believe that structures do matter are more or less evenly split between proponents of independent-agency and executive branch status, quasi-judicial and informal decision making, and single-administrator and multi-commissioner format, so that they practically cancel each other out. The political actors, for their part, typically take a strong interest in the subject even if they do not have an interest in the substantive outcomes.

Perhaps the assertion that would meet with the widest approval is that deregulation should be taken as far as it can go before any structural reform is attempted (which is the Transportation Department's position, too). As one Capitol Hill staffer put it: "Empty the boxes before you stack them."

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(Continued from page 4)
many exceptions to antitrust laws, and even now is considering further exemptions for cooperative R & D ventures, various sports interests, and the brewing industry.

We also disagree on the notion that "price fixing does not create information, but destroys it." Unanimous agreement to a standard list price for similar services need not imply uniform pricing, since individual firms may maintain discounts. It just makes it easier for the shipper, especially the occasional shipper, to compare carriers and take advantage of relative efficiencies (and for carriers themselves to observe market conditions). Those agreements that bind member businesses to rigid price schedules unrelated to cost are the likeliest to founder on market forces, precisely because they throw away information.

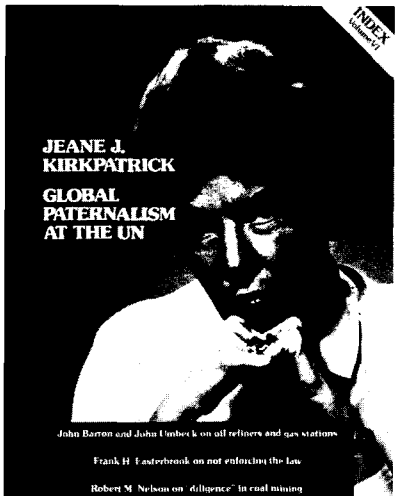
Although not many antitrust debates stray into theology in its literal sense, I would like to take issue with Moore's view that few major religions sanction libertarian values. I do not know of any major religion that requires believers to initiate force in quest of moral outcomes; indeed, free will, a central concept in most religions, implies that it is impossible to achieve virtue unless one is free to act wrongly. As a practical matter, furthermore, the conditions of economic freedom and prosperity seem to provide the best opportunity for truly civilized, and therefore moral, societies to emerge.

Advocacy Funding: The Constitutional Implications

TO THE EDITOR:

Your "Perspectives" piece, "OMB's 'Wall of Separation' against Tax-Funded Advocacy" (*Regulation*, January/February 1983), takes an astonishingly cavalier attitude toward the administration's patently unconstitutional proposal for regulating "advocacy funding." Like OMB, you argue that the balance to be struck is "between liberty and liberty," since—as you say in a puzzling ex cathedra pronouncement—"the taxpayers who wish not to subsidize advocacy have an even more legitimate liberty interest than do the grantees." You adopt this view notwithstanding your purported recognition that "the Constitution does not protect individual taxpayers from having to support federal programs they dislike."

It is plainly specious to argue that the federal government infringes upon constitutional liberties whenever it uses taxpayer money to subsidize the advocacy of ideas with which individual taxpayers do not agree. Whenever the president makes a speech, an agency official lobbies Congress, a department publishes the draft of a regulation, or the executive branch takes any other policy initiative that is unconstrained by statute, viewpoints are being funded with taxpayer money without any assurance that even a single taxpayer supports such viewpoints. This funding occurs without any executive official having to "survive" any "obstacle course the Founders built to discourage laws for which there is no general consensus." Officials may abuse this privilege by using federal money for blatant partisanship or the aggrandizement of wholly idiosyncratic points of view, but such abuses, however reprehensible, do not violate the Constitution.


INDEX
JEANE J. KIRKPATRICK
GLOBAL PATERNALISM AT THE UN
John Barron and John Umbeck on oil refiners and gas stations
Frank H. Easterbrook on not enforcing the law
Robert M. Nelson on "diligence" in coal mining

Similarly, Congress's enactment of any government spending program requires some taxpayers to support a viewpoint they dislike. Again, there is no particular "obstacle course." The only effective constitutional requirements for a spending bill are majority votes in both houses of Congress and the president's signature—not any "general consensus." That is why, for example, the government funds maternal health and childbirth programs, but not abortions.

Just as the federal government may legitimately use public funds to advance a point of view, so, in particular cases, may federal grantees. Although it may be a reasonable policy position that federal funds ought not to be used to support such activity, this rule has equally reasonable exceptions. If Congress should decide, for example, that the regulatory decision making of an agency would be improved by funding the participation of groups that otherwise could not afford to speak effectively, then such funding could be defended as being in the public interest. That the viewpoint expressed by such a funded party may be in some sense "private" does not invalidate its inclusion in public policy debate as a way to serve a more general social interest for which Congress can legitimately provide the funds.

Even assuming that a policy against advocacy funding does represent the wiser use of federal resources, there is still no justification for the stark overreaching of the OMB proposal—which would, for example, preclude an employee of a grantee, a fraction of whose salary is supplied by the federal government, from using private resources to engage in lobbying, political campaigning, legal advocacy, or other politically related public relations functions. Such a sweeping ban may be easier to enforce; but given the rule's chilling effect on private advocacy, so poor a fit between the government's asserted purpose and the actual scope of its regulation cannot be defended under the First Amendment. There simply is no compelling, or even significant, social interest that justifies prohibiting so much privately funded political advocacy in order to achieve more convenient enforcement of a lobbying ban.

The one thing that can be said in favor of the OMB proposal is its surface evenhandedness. However much the proposal may have been animated by hostility toward such traditionally liberal agencies as VISTA, the Community Services Administration, and the Legal Services Corporation, the administration—in trying to silence the liberal voices—is at least willing to put the clamp on friendlier lobbyists as well. One wonders, however, amid the current enthusiasm for regulatory analysis, whether somewhere in the files of OMB there is a cost-benefit study indicating the relative impact this proposal would have on the Reagan administration's friends and foes.

Peter M. Shane,
University of Iowa
College of Law

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THE EDITORS respond:

We cited Justice Hugo Black's view that the First Amendment bans even "one single penny" of advocacy funding. Shane seems to find Black's rule "plainly specious" because it is now broken so often, in letter and spirit, by the executive branch.

Yes, presidents and cabinet officers are free to lobby Congress or mobilize pressure groups, just as they are personally free to involve themselves in controversies of other sorts—by campaigning for senatorial candidates or leading religious movements, for example. The question here is whether it is improper for them to spend program funds by the million to further these personal efforts. In many cases Congress has decreed its impropriety: Title 18, section 1913 of the U.S. Code flatly prohibits executive agencies from lobbying with appropriated moneys.

We agree with Shane that executive officials find it very easy to spend discretionary funds on other sorts of advocacy—but that is an argument for, not against, our position. There is no need to resolve the quibble over whether the process by which a bill becomes law is an "obstacle course"; if it is a simple process, all the less reason for an executive official to short-circuit it by spending money on one side of a controversy that Congress has not yet acted on.

And any misgivings about elected officials' advocacy apply triply to grantee advocacy. Elected officials are directly accountable to the voters; the federal bureaucracy (which is covered by such laws as the Hatch Act, as well as section 1913) less so; and grantees least of all. Even assuming that the civil servants who administer the grant do not sympathize with the grantees' illicit lobbying, they find it hard to enforce anti-advocacy rules after the fact, especially since grantees frequently enjoy due process rights that can amount in practice to a presumption of grant renewal. Grantees very often retain their funding even after their original sponsors have been repudiated at the polls.

Shane's only stated reason for considering the regulations unconstitutional is their "overreaching" and "poor fit," which suggests that he agrees with us that prudent balancing is needed at the margin. Such balancing would be made easier if OMB's opponents were willing to admit that advocacy funding raises serious questions of ethical governance. ■

Spectrum Fees vs. Spectrum Liberation

(Continued from page 25)

functions serve as a handy excuse for restricting competitors: the NAB argues against deregulating direct broadcast satellites and for requiring cable to carry local TV stations (the "must carry" rule) on the grounds that these rules help ensure public service broadcasts. Indeed, the NAB has actively opposed every effort by the FCC to undo these rules. What it seems to want is not a property right in an unregulated competitive market, but something like a feudal land grant, held under strict conditions and not to be transferred to just anyone that happens along.

New competition should be a highly attractive alternative for those, like Representative Wirth, who believe television is not sufficiently competitive now. It is the broadcasters who are the real roadblocks to reform. After all, they have little to lose if Congress fails to act. Their license tenure is already fairly secure. Of the last 14,000 licenses to come up for renewal, less than 100 were put up for evidentiary hearings. Only two stations have lost their licenses in the past forty years through petitions to deny, and not many more through comparative renewal. Add to this the recent law extending license terms and a recent court case that gave incumbent licensees a "renewal expectancy," and what is left of the broadcasters' motive to change the system?

Senator Robert Packwood, whose crusade for First Amendment rights for electronic media has been foundering on broadcaster apathy, has been moved to comment, "I sometimes wonder deep down if broadcasters really, really want out from under the content doctrines." A few months ago the influential trade journal *Broadcasting* asserted that "a growing faction in the industry appear to be having second thoughts about pursuing further deregulation at all. Their reasoning: that the game isn't worth the candle; that the benefits of further bargains would be far exceeded by the price extracted by Congress."

Perhaps the real lesson of the fee-vs.-deregulation struggle is that it represents a tremendous failure of the imagination on the part of all concerned. The revolution in telecommunications technology demands an equally comprehensive reform of the premises of regulation. Yet the spectrum fee proposals try to avoid the necessity of making radical alterations by striking a bargain among the established players. Broadcasters would get more freedom without being subject to the discipline of a full market. Public stations would get a cozy subsidy. Congress would get extra revenue (depending on the size of the fee). In short, everyone would get a quid pro quo except consumers—who want and deserve added diversity. All very neat for the established powers, but it hardly deserves the name of deregulation, or the support of neutral observers. ■

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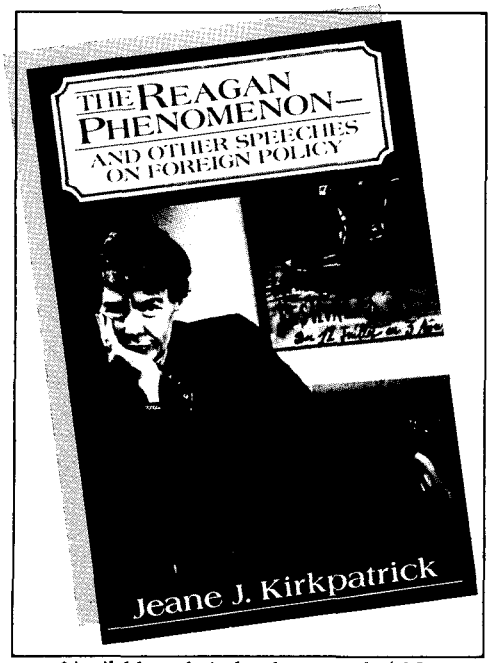

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